(10)

No. 90-741-CFX
Status: GRANTED

Title: Aletha Dewsnup, Petitioner
v.
Louis L. Timm, et al.

Docketed:
November 8, 1990

Court: United States Court of Appeals
for the Tenth Circuit

Counsel for petitioner: Dyk,Timothy B.

Counsel for respondent: Hayes,Michael Z., Taranto,Richard G.

9/20: Ord. granting ext. of time to file, to and incl. 11/8, by White, J. (CITED); 40 printed copies recd. 11/8.

Entry	Date	Note	Proceedings and Orders
1	Sep 19 1990	G	Application (A90-219) to extend the time to file a petition for a writ of certiorari from October 9, 1990 to November 8, 1990, submitted to Justice White.
2	Sep 20 1990		Application (A90-219) granted by Justice White extending the time to file until November 8, 1990.
3	Nov 8 1990	G	Petition for writ of certiorari filed.
5	Dec 10 1990		Order extending time to file response to petition until January 10, 1991.
7	Jan 8 1991		Order extending time to file response to petition until January 24, 1991.
8	Jan 23 1991		Brief of respondents Louis L. Timm, et al. in opposition filed.
9	Jan 25 1991		Reply brief of petitioner Aletha Dewsnup filed.
10	Jan 30 1991		DISTRIBUTED. February 15, 1991
11	Jan 31 1991		Letter from respondent received and distributed.
12	Feb 1 1991		Letter from petitioner in response to letter from respondents received and distributed
13	Feb 19 1991		Petition GRANTED.
			**********
15	Mar 11 1991		Order extending time to file brief of petitioner on the merits until April 26, 1991.
16	Apr 18 1991		Brief amicus curiae of Consumers Education and Protective Assn. filed.
18	Apr 26 1991		Brief of petitioner Aletha Dewsnup filed.
19	Apr 26 1991		Joint appendix filed.
17	Apr 29 1991		Lodging Received.
30	May 14 1991	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
21	May 15 1991		Order extending time to file brief of respondent on the merits until June 12, 1991.
22	Jun 12 1991		Brief of respondents Louis L. Timm, et al. filed.
23	Jun 12 1991		Brief amicus curiae of United States filed.
24	Jun 19 1991	G	Application (A90-969) to extend the time to file a reply brief from July 12, 1991 to July 26, 1991, submitted to Justice White.
25	Jun 21 1991		Application (A90-969) granted by Justice White extending the time to file until July 26, 1991.

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No. 90-741-CFX

Entry	Date	Note	Proceedings and Orders
26	Jul 15 1991		CIRCULATED.
27	Jul 19 1991		SET FOR ARGUMENT TUESDAY, OCTOBER 15, 1991. (2ND CASE)
28	Jul 26 1991	X	Reply brief of petitioner Aletha Dewsnup filed.
29	Jul 26 1991		Certified copy of Court of Appeals proceedings received.
31	Aug 13 1991		Record filed.
		*	Received certified copy of pleadings and original recordfrom USDC D. Utah.
32	Sep 13 1991		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
33	Oct 15 1991		ARGUED.

90-741

No. ———

Supreme Court, U.S.
FILED
NOV 8 1990
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

---

PETITION FOR A WRIT OF CERTIORARI

TIMOTHY B. DYK
(Counsel of Record)
PATRICIA A. DUNN
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939
Counsel for Petitioner

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether Section 506(d) of the Bankruptcy Code enables a Chapter 7 debtor to void a lien on real property abandoned by the bankruptcy trustee to the extent that the lien exceeds the property's value.

PARTIES TO THE PROCEEDING

The parties to the proceedings in the court below were: Lamar and Aletha Dewsnup and Louis L. Timm, John Neiuwland and Floyd M. Childs, Trustees of the United Precision Machine and Engineering Company Profit-Sharing Trust; ABCO Insurance Agency, Inc.; and Joseph L. Henroid, as Trustee for the Annette Jacob Trust.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. ——

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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PETITION FOR A WRIT OF CERTIORARI

Aletha Dewsnup respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit (App., *infra*, at 1a-11a) is reported at 908 F.2d 588. The order of the United States District Court for the District of Utah, affirming the judgment of the bankruptcy court, is unreported (App., *infra*, at 12a-13a). The memorandum opinion of the United States Bankruptcy Court for the District of Utah (App.,

infra, at 16a-32a) is reported at 87 B.R. 676; its order of dismissal is unreported (App., *infra*, at 14a-15a).

JURISDICTION

The court of appeals entered its judgment on July 11, 1990. On September 20, 1990, this Court granted Petitioner's request for an extension of time to file her Petition for a Writ of Certiorari until November 8, 1990. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 506 of the Bankruptcy Code, 11 U.S.C. § 506, provides:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.
>
> (b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.
>
> (c) The trustee may recover from property securing an allowed secured claim the reasonable, ne[illegible]es-

> sary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.
>
> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—
>
> (i) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
>
> (ii) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, provides in pertinent part:

> (a) The commencement of a case under section 301, 302 or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case. . . .

Section 554 of the Bankruptcy Code, 11 U.S.C. § 554, provides in pertinent part:

> (a) After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate. . . .

Section 722 of the Bankruptcy Code, 11 U.S.C. § 722, provides in pertinent part:

> An individual debtor may . . . redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under Section 522 of this title or has been abandoned under Section 554 of this title, by paying the holder of such lien the amount of the allowed

secured claim of such holder that is secured by such lien.

STATEMENT

This case involves the question whether Section 506 of the Bankruptcy Code, 11 U.S.C. § 506, permits a debtor, who files a petition under Chapter 7 of the Code, to void a lien on abandoned real property to the extent that the lien exceeds the value of the property. The property in this case consists of two parcels of farmland in Utah that Petitioner Aletha Dewsnup and her now-deceased husband owned outright until 1978 (Record on Appeal ("ROA") 12, 44). On June 1, 1978, the Dewsnups mortgaged both parcels to respondents (*id.*). Respondents claim that they have a judgment lien on this property that secures an indebtedness now exceeding $140,000 (*id.* at 12-13, 44-45).

In June 1984, after two unsuccessful attempts at reorganization under Chapter 11 of the Bankruptcy Code, the Dewsnups commenced proceedings to liquidate their assets under Chapter 7 (ROA 45). Under the Bankruptcy Code's automatic stay provision, 11 U.S.C. § 362, the filing of the Dewsnups' petition stayed a foreclosure sale on their property. Because the Dewsnups believed that the amount of respondents' lien exceeded the fair market value of the mortgaged farm property, they sought to void a portion of the lien under Section 506 of the Bankruptcy Code (ROA 11-19). Section 506 provides that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . ." (11 U.S.C. § 506(a)); it further provides that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void. . . ." *Id.*, § 506(d).

In their Section 506 adversary proceeding, the Dewsnups requested the bankruptcy court (1) to determine the extent of the respondents' secured claim on the property and (2) to void the lien to the extent that respondents' claim exceeded the value of the property (App., *infra*, at 16a). The Dewsnups also sought to redeem the property by paying the respondents the fair market value of the property (*id.*). During these proceedings, the bankruptcy trustee apparently agreed that the value of the property was less than the lien and that unsecured creditors would realize nothing in a sale of the property; accordingly, the trustee abandoned the Dewsnups' property pursuant to Section 554 of the Bankruptcy Code because it was burdensome to the bankruptcy estate (*id.* at 3a n.2).

The bankruptcy court valued the Dewsnups' property at $39,000—substantially less than the over $140,000 claimed value of the respondents' lien—but declined to allow the Dewsnups to void the lien to the extent that it exceeded the property's value (App., *infra*, at 2a, 16a). The bankruptcy court held that Section 506(d) was inapplicable because it applies only to "property in which the estate has an interest" (*id.* at 24a, citing 11 U.S.C. § 506(a)); in the court's view, property that the estate has abandoned under Section 554 of the Bankruptcy Code "is no longer property of the estate and the estate, consequently, has no interest in the property" (App., *infra*, at 24a).

The district court summarily affirmed the bankruptcy court's decision (App., *infra*, at 12a-13a) and, on appeal, the Tenth Circuit affirmed in turn (*id.* at 1a-11a). The court of appeals initially noted that the "courts are clearly divided" on the question whether a Chapter 7 debtor can void the undersecured portion of a lien on abandoned real property under Section 506(d) and that a majority of courts, including the Third Circuit in *Gaglia v. First Federal Savings & Loan Ass'n*, 889 F.2d 1304 (3d Cir. 1989), had held that a debtor can do so (App., *infra*, at 3a). The Tenth Circuit nonetheless expressly "reject[ed] the analysis of the Third Circuit in

Gaglia" (*id.* at 4a) and joined those courts that had declined to permit debtors to void undersecured liens on abandoned real property under Section 506(d) (*id.* at 3a).

In reaching this result, the Tenth Circuit agreed with the bankruptcy court that Section 506(a) applies only to "property in which the estate has an interest" (App., *infra*, at 5a-6a). The court concluded that the trustee's abandonment of the property meant that the estate no longer had an "interest" in the property and that Section 506(d) was inapplicable (*id.* at 6a-8a). The court of appeals also reasoned that allowing Chapter 7 debtors to use Section 506(d) to retain abandoned property (1) undercuts Congress' preference for reorganization rather than liquidation by allowing debtors to receive "more in liquidation than they would receive in a reorganization" (*id.* at 8a-9a); and (2) somehow converts Section 506(d) into a redemption provision, even though Congress had expressly provided only for the redemption of personal, not real, property in Section 722 (*id.* at 9a-10a). Finally, the court of appeals concluded that allowing lien avoidance under Section 506(d) unfairly deprives creditors of any post-petition appreciation in property and gives debtors "much more than the 'fresh start' to which they are entitled" (*id.* at 10a-11a).

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW CONFLICTS WITH THE MAJORITY OF FEDERAL COURT DECISIONS CONSTRUING SECTION 506(d) OF THE BANKRUPTCY CODE

The court below recognized that its decision was in direct conflict with the Third Circuit's decision in *Gaglia v. First Federal Savings & Loan Ass'n*, 889 F.2d 1304 (3d Cir. 1990), but rejected the holding and the analysis of that court (App., *infra*, at 3a-4a). In *Gaglia*, the Third Circuit concluded that Section 506(d) provides for lien avoidance on all "property in which the estate has an interest" (11 U.S.C. § 506(a)) and that such property broadly includes property, like abandoned property, that the estate does not administer in bankruptcy proceedings. 889 F.2d at 1307-08. Contrary to the Tenth Circuit, therefore, the Third Circuit held that that the plain language of Section 506(d) permits debtors to void the unsecured portion of creditors' liens on real property to the extent that those liens exceed the property's value, even if the estate has abandoned the property. *Id.*

The court below likewise acknowledged that "two other circuits . . . have recognized a debtor's ability to void liens under section 506(d)" but declined to follow them (App., *infra*, at 3a, citing *In re Folendore*, 862 F.2d 1537, 1539 (11th Cir. 1989) and *In re Lindsey*, 823 F.2d 189, 191 (7th Cir. 1987)). In *Folendore*, the Eleventh Circuit stated that the "plain language" of Section 506(d) allows a Chapter 7 debtor to void the unsecured portion of a lien on real and personal property. 862 F.2d at 1539. The Seventh Circuit in *Lindsey* likewise recognized that Chapter 7 debtors can "strip-down" liens under Section 506(d) to the extent that they exceed the value of abandoned real property. 823 F.2d at 190-91.

An even broader conflict has developed in the bankruptcy courts, which are divided concerning the applicability of Section 506(d)'s lien avoidance provision to real property in Chapter 7 proceedings. Eighteen bankruptcy courts have held that Chapter 7 debtors can void the undersecured portions of real property liens under Section 506(d). *See In re Kostecky*, 111 B.R. 823 (Bankr. D. Minn. 1990); *In re Donahue*, 110 B.R. 41 (Bankr. D. Kan. 1990); *In re Moses*, 110 B.R. 962 (Bankr. N.D. Okla. 1990); *In re Zobenica*, 109 B.R. 814 (Bankr. W.D. Tenn. 1990); *In re Zlogar*, 101 B.R. 1 (Bankr. N.D. Ill. 1989); *In re Hunter*, 101 B.R. 294 (Bankr. S.D. Ala. 1989); *United States v. Garnett*, 99 B.R. 757 (W.D. Ky. 1989), *aff'g*, 88 B.R. 123 (Bankr. W.D. Ky. 1988); *In re Crouch*, 76 B.R. 91 (Bankr. W.D. Va. 1987); *In re O'Leary*, 75 B.R. 881 (Bankr. D. Ore. 1987); *In re Worrell*, 67 B.R. 16 (C.D. Ill. 1986); *In re Cleveringa*, 52 B.R. 56 (Bankr. N.D. Iowa 1985); *In re Lyons*, 46 B.R. 604 (Bankr. N.D. Ill. 1985); *In re Gibbs*, 44 B.R. 475 (Bankr. D. Minn. 1984); *In re Bracken*, 35 B.R. 84 (Bankr. E.D. Pa. 1983); *Brace v. State Farm Mutual Automobile Ins. Co.*, 33 B.R. 91 (Bankr. S.D. Ohio 1983); *In re Vigne*, 18 B.R. 946 (Bankr. W.D. Pa. 1982); *In re Tanner*, 14 B.R. 933 (Bankr. W.D. Pa. 1981); *In re Lindsey*, 64 B.R. 19 (C.D. Ill. 1986).

In contrast, thirteen bankruptcy courts have reached a contrary conclusion, holding that Section 506(d) is inapplicable to real property liens in Chapter 7 proceedings generally, or at least in those proceedings involving abandoned real property. *See In re Mammoser*, 115 B.R. 758 (Bankr. W.D.N.Y. 1990); *In re Israel*, 112 B.R. 481 (Bankr. D. Conn. 1990); *In re D'Angona*, 107 B.R. 448 (Bankr. D. Conn. 1989); *In re Doty*, 104 B.R. 133 (Bankr. S.D. Iowa 1989); *In re Larson*, 99 B.R. 1 (Bankr. D. Alaska 1989); *In re Shrum*, 98 B.R. 995 (Bankr. W.D. Okla. 1989); *In re Hoyt*, 93 B.R. 540 (Bankr. S.D. Iowa); *In re McLaughlin*, 92 B.R. 913

(Bankr. S.D. Cal. 1988); *In re Smith*, 79 B.R. 650 (Bankr. D. Md. 1987); *In re Maitland*, 61 B.R. 130 (Bankr. E.D. Va. 1986); *In re Sloan*, 56 B.R. 726 (Bankr. D. Colo. 1986); *In re Cordes*, 37 B.R. 582 (Bankr. C.D. Cal. 1984); *In re Mahaner*, 34 B.R. 308 (Bankr. W.D. N.Y. 1983).

The decision below is, moreover, contrary to the leading treatise on bankruptcy law. In *Collier on Bankruptcy*, the author recognizes the conflict concerning whether Section 506(d) applies to real property in Chapter 7 proceedings, but explains that the minority position, holding that Section 506(d) is not applicable in such circumstances, "is directly contrary to the clear language of section 506(d) and the majority of cases which have considered the matter." 3 *Collier on Bankruptcy*, ¶ 506.07, at 506-75 (15th ed. 1989). Other authors have analyzed this conflict, reaching divergent opinions on the proper interpretation of Section 506(d).[1]

This substantial conflict concerning the scope of Section 506(d) warrants this Court's review.

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[1] *See* Note, *In Rem Lien Avoidance in Chapter 7: Lenders Beware*, 7 Bankr. Dev. J. 155, 172-73 (1990) (reviewing divergence of opinion on applicability of Section 506(d) to real property); Note, *The Debtor's Right to Restrict Lienholder Recovery to the Value of the Encumbered Property under Section 506 of the Bankruptcy Code*, J. Corp. L. 433, 434 (Spring 1986) (reviewing split in authority and endorsing majority view that Section 506(d) is available to Chapter 7 debtors seeking to void undersecured liens on real property); Note, *Can a Debtor Void a Lien on Real Property That Exceeds the Value of the Collateral?: An Interpretation of Section 506(d) of the Bankruptcy Code*, 45 Wash. & Lee L. Rev. 1393, 1410-11 (1988) (reviewing split in authority and endorsing minority view that Section 506(d) does not allow Chapter 7 debtors to void real property liens).

II. THE DECISION BELOW IS CONTRARY TO THE PLAIN LANGUAGE OF SECTION 506(d) OF THE BANKRUPTCY CODE

It is quite clear that the court below erred in construing Section 506(d), contrary to its plain words, to preclude Chapter 7 debtors from voiding liens on abandoned real property to the extent that they exceed the property's value. This Court has recently noted, in another case involving Section 506, that "[t]he task of resolving the dispute over the meaning of § 506[] begins where all such inquiries must begin: with the language of the statute itself." *United States v. Ron Pair Enterprises*, 109 S. Ct. 1026, 1030 (1989).[2] That inquiry highlights the court of appeals' error in this case.

Section 506 "governs the definition and treatment of secured claims, *i.e.*, claims by creditors against the estate that are secured by a lien on property in which the estate has an interest." *United States v. Ron Pair Enterprises*, 109 S. Ct. at 1029. Subsection (a) provides that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim" (11 U.S.C. § 506(a)); this means, in this Court's words, that "a claim is secured only to the extent of the value of the property on which the lien is fixed." *United States v. Ron Pair Enterprises*, 109 S. Ct. at 1029. Subsection (d), in turn, provides that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void. . . ." 11 U.S.C. § 506(d). Nothing in

[2] In *Ron Pair*, this Court held that the plain language of Section 506(b) of the Bankruptcy Code entitles creditors to post-petition interest on nonconsensual, oversecured allowed claims. 109 S. Ct. at 1030-31.

the plain language of Section 506(d) or this Court's description of the provision suggests that Section 506(d) is inapplicable to real property, much less abandoned real property.[3]

The Tenth Circuit refused to apply Section 506 on the ground that Section 506 is inapplicable to property that the estate has abandoned under Section 554 because abandoned property ceases to be "property of the estate" (App., *infra*, at 5a-6a). But Section 506 does not confine its scope to "property of the estate"; rather, it more broadly encompasses all "property in which the estate has an interest." 11 U.S.C. § 506(a). Though undefined in the statute, this latter phrase logically includes both "property of the estate" (11 U.S.C. § 541) *and* property, like property abandoned under Section 554, that is of interest to the estate, but is not technically "property of the estate." *See Gaglia v. First Federal Savings & Loan Ass'n*, 889 F.2d at 1307-08; *In re Gibbs*, 44 B.R. at 478-79; *cf. In re Shrum*, 98 B.R. 995, 1001 (Bankr. W. D. Okla. 1989) (noting that Chapter 12 and 13 debtors often propose plans that deal with abandoned or exempted property even though such property is not "property of the estate," in that the property is still property in which the estate has an interest). This distinction is not inadvertent. Congress considered, but rejected, an early version of Section 506 that limited the provision to "property of the estate"—opting instead for the broader language in the statute as enacted.[4]

[3] This subsection states only two limitations on voiding liens under Section 506, neither of which is relevant here: it makes clear that the undersecured portions of liens are not void if (1) the underlying claim is disallowed only under Section 502(b)(5) or Section 502(e), which deal with unmatured debt and co-debtor claims, or (2) the claim is not an allowed secured claim due only to the creditor's failure to file a proof of claim. 11 U.S.C. § 506(d)(1-2).

[4] *Compare* 11 U.S.C. § 506(a) *with* H.R. 6, 95th Cong., 1st Sess. § 506(a) (1977) ("An allowed claim of a creditor secured by a lien on *property of the estate* is a secured claim to the extent of

The Tenth Circuit itself has implicitly recognized that the estate has an "interest" in abandoned property; it effectively conceded that Section 506 applies to certain items of *personal* property that the debtor may redeem under Section 722 of the Code after voiding an excess lien (App., *infra*, at 9a-10a).[5] But, in an exercise of tortured reasoning, the Court found in Section 722 a justification for its refusal to apply Section 506(d) to abandoned real property; it concluded that Section 722's " 'exclusion of real property . . . and its express limitation to specific tangible personal property [make it] obvious that Congress did not intend to permit a debtor to redeem his real property through the use of § 506(d)' " (App., *infra*, at 9a-10a; citation omitted).[6]

The court below has, however, misunderstood the Code and confused the concepts of lien avoidance and redemption. Section 506(d) voids liens on both real and personal property. It is not a redemption provision. The specific redemption provision of Section 722 exists because Congress perceived a need to prevent abuses peculiar to consumer credit arrangements by enacting a redemption mechanism for personal property that "is broader than rights of redemption under the Uniform Commercial Code." *See* H.R. No. 595, 95th Cong., 1st Sess. 380-81 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6336. This simply does not demonstrate that Congress intended to deprive Chapter 7 debtors of the right

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the value of such creditor's interest in such property . . ."), *quoted in* 3 *Collier on Bankruptcy*, ¶ 506.03, at 506-7) (emphasis added).

[5] Section 722 expressly applies to abandoned property (*see* 11 U.S.C. § 722), and its operation is dependent on lien valuation and avoidance under Section 506. *See* 4 *Collier on Bankruptcy* 722.05, at 722-7 (15th ed. 1989).

[6] In this portion of its opinion, the court of appeals may have stated an even broader holding: that Section 506(d) does not apply at all to real property in Chapter 7 proceedings, regardless of whether the estate has abandoned the property.

to void liens on real property under Section 506(d) and to redeem that property pursuant to state law.[7]

Indeed, Section 506(d), like the many other protections that Congress enacted in 1978, is critical to the debtor's "fresh start" under Chapter 7. *In re Folendore*, 862 F.2d at 1540. In many cases, application of Section 506(d)'s avoidance provision will enable debtors to retain possession of their property without having to pay off liens that far exceed the value of the property. With reduced (and realistic) liens, some debtors may be able to redeem their property outright from secured creditors, as petitioner seeks to do here; other debtors may be able to negotiate a repayment schedule with those creditors based on the reduced amount of the lien. *See Gaglia v. Federal Savings & Loan Ass'n*, 889 F.2d at 1308. While Section 506(d) protects creditors to the extent that they hold secured claims against the debtor's property—they will, after all, receive the value of the property through liquidation, redemption or negotiated repayment—it thus prevents erosion of one of the Bankruptcy Code's central purposes: avoiding impairment of the debtor's "fresh start" through post-bankruptcy foreclosures and deficiency judgments. *Id.* at 1308-09.

III. THE PROPER INTERPRETATION OF SECTION 506(d) OF THE BANKRUPTCY CODE IS AN IMPORTANT AND RECURRENT ISSUE

This case presents an important, and frequently recurring, issue concerning the proper interpretation of the Bankruptcy Code. Despite the enormous amount of litigation arising under Section 506(d)—evidenced by the over 30 reported decisions on this issue (*see* discussion,

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[7] The Tenth Circuit's suggestion that Section 506(d) should somehow not apply in Chapter 7 liquidations, but only in reorganizations under Chapters 11, 12 and 13, is equally difficult to fathom (App., *infra*, at 8a-9a). Nothing on the face of Section 506(d) limits it in this manner, and it is essential that it apply in Chapter 7 proceedings if Section 722 is to have any meaning.

supra, at 7-8)—the courts have been unable to reach a consensus concerning the proper interpretation of Section 506(d). This confusion threatens the uniform administration of the Bankruptcy Code and, absent this Court's review, will continue to spawn patchwork results in federal bankruptcy proceedings.

Resolution of the issue presented in this case—whether Section 506(d) of the Bankruptcy Code enables a Chapter 7 debtor to void a lien on abandoned real property to the extent that the lien exceeds the property's value—is vital to debtors and creditors who seek protection under the Bankruptcy Code. Bankruptcies are not uncommon. As of June 30, 1989, nearly 880,000 bankruptcy cases were pending in the federal courts; in 1989 alone, nearly 650,000 new bankruptcy cases—including almost 420,000 individual Chapter 7 cases—were filed in the federal courts. *See Reports of the Proceedings of the Judicial Conference of the United States, Annual Report of the Director of the Administrative Office of the United States Courts* (1989), Tables F & F-2, at 358, 362. Though precise statistics are unavailable, many of these proceedings involve farmer bankruptcies. As one commentator has noted, "the indebtedness of American agriculture . . . assumed drastic proportions" in the early 1980s, as land values declined, interest rates rose and commodity prices dropped, and pushed many farmers into bankruptcy. Grossman, *Troubled Times: The Farm Debtor Under the Amended Bankruptcy Code*, 38 Okla. L. Rev. 579, 581-82 (1985). In the current economic climate, the number of bankruptcies—including the number of farm bankruptcies—is unlikely to decline.

Disputes over the availability of Section 506(d) to Chapter 7 debtors will, therefore, predictably recur with some frequency. While not all bankruptcies involve adversary proceedings to void liens on real property under Section 506(d), the numerous published cases on this issue suggest that many do (*see* discussion, *supra*, at

7-8). Only this Court can provide the urgently-needed guidance to the federal courts concerning the proper interpretation of Section 506(d).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

TIMOTHY B. DYK
(Counsel of Record)
PATRICIA A. DUNN
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939
Counsel for Petitioner

November 8, 1990

APPENDIX

APPENDIX

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 89-4067

IN RE: LAMAR DEWSNUP and ALETHA DEWSNUP,
Debtors,

LAMAR DEWSNUP,
Plaintiff,

ALETHA DEWSNUP,
Plaintiff-Appellant,

v.

LOUIS L. TIMM, *et al.*,
Defendants-Appellees.

Appeal from the United States District Court
for the District of Utah
(D.C. No. 88-C-0841G)

[Filed July 11, 1990]

Submitted on the briefs:

William Thomas Thurman and Scott C. Pierce, of McKay, Burton & Thurman, Salt Lake City, Utah, for Plaintiffs-Appellants.

Michael Z. Hayes, of Mazuran, Verhaaren & Hayes, P.C., Salt Lake City, Utah, for Defendants-Appellees.

Before ANDERSON, BARRETT, and BALDOCK, Circuit Judges.

PER CURIAM.

The issue presented in this appeal is whether a Chapter 7 debtor may use 11 U.S.C. § 506(d) of the Bankruptcy Code to void the undersecured portion of a lien on real property which has been abandoned by the bankruptcy estate.[1]

Facts

Debtors Aletha and Lamar Dewsnup filed a Chapter 7 bankruptcy petition in 1984. Within that case, they commenced this adversary proceeding to determine the validity and extent of a note and trust deed held on real property they own in Millard County, Utah. The two parcels of land are used for farming and are not the debtors' primary residence. The various appellees are the secured creditors of the property.

At the trial of this matter, debtors argued they could use section 506(d) to redeem this property. Specifically, they asserted this section allows them to void creditors' liens to the extent they exceed the fair market value of the parcels. At the time of trial, the bankruptcy court valued the land at $39,000. The note and trust deed held by creditors are far in excess of that amount. Debtors assert section 506(d) allows them to fully redeem the

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[1] After examining the briefs and appellate record, this panel has determined unanimously that oral argument would not materially assist the determination of this appeal. *See* Fed. R. App. P. 34(a); 10th Cir. R. 34.1.9. The case is therefore ordered submitted without oral argument.

property by tendering the assessed market value to creditors in cash. Although it was not entirely clear at the time of trial, the bankruptcy trustee has abandoned this property pursuant to 11 U.S.C. § 554(a).[2]

The bankruptcy court dismissed debtors' argument, holding section 506(d) was not intended to be used in this manner. *See In re Dewnsnup*, 87 Bankr. 676, 683 (Bankr. D. Utah 1988). The district court affirmed. On appeal, debtors urge this court to reject the bankruptcy court's reasoning and join the majority of courts which have allowed avoidance under section 506(d).

Discussion

Although courts are clearly divided on this issue, a majority have adopted the position which debtors urge. *See In re Gaglia*, 889 F.2d 1304, 1306-11 (3d Cir. 1989); *In re Brouse*, 110 Bankr. 539, 541 (Bankr. D. Colo. 1990); *In re Moses*, 110 Bankr. 962, 963-64 (Bankr. N.D. Okla. 1990); *In re Zlogar* 101 Bankr. 1, 7 (Bankr. N.D. Ill. 1989); *In re Tanner*, 14 Bankr. 933, 939 (Bankr. W.D. Pa. 1981). Included within this majority is the Third Circuit, which is the only circuit court to specifically address this issue. *See Gaglia*, 889 F.2d at 1306. Two other circuit courts have addressed questions which are tangentially related, and have recognized a debtor's ability to void liens under section 506(d). *See In re Folendore*, 862 F.2d 1537, 1539 (11th Cir. 1989); *In re Lindsey*, 823 F.2d 189, 191 (7th Cir. 1987).

However, a strong minority of courts have rejected this approach, concluding it is inconsistent with the in-

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[2] In the district court there was some question whether the property was abandoned by the trustee. However, in their brief to this court, debtors admit that the property was abandoned following the 1988 trial of this adversary proceeding. Appellant's Brief at 3; *see also In re Dewsnup*, 87 Bankr. 676, 677 n.1 (Bankr. D. Utah 1988) (for purpose of the bankruptcy court decision, court assumed the property was abandoned).

tended purpose of the section and is unfair to lienholders. *See In re Shrum*, 98 Bankr. 995, 1002 (Bankr. W.D. Okla. 1989); *In re McLaughlin*, 92 Bankr. 913, 915 (Bankr. S.D. Cal. 1988); *Dewsnup*, 87 Bankr. at 683; *In re Maitland*, 61 Bankr. 130, 134-35 (Bankr. E.D. Va. 1986).

Courts denying relief under this section have stated various reasons for doing so, including: 1) that abandoned property is not administered by the estate and therefore sections 506(a) and (d) have no application; 2) that allowing this relief inequitably gives debtors more in a Chapter 7 liquidation than they would receive in the reorganization chapters; and finally, 3) that allowing avoidance pursuant to section 506(d) renders the redemption provision found in Code section 722 meaningless. Because we agree with the district court's sound reasoning in this case, we reject the analysis of the Third Circuit in *Gaglia* and affirm.

Code sections 506(a) and (d) provide the starting point for our analysis. Those sections state:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.
>
> . . . .

> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless—
>
> (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
>
> (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. § 506(a) and (d).

These sections were included in the Code to govern the definition and treatment of secured claims. *United States v. Ron Pair Enters., Inc.*, 109 S. Ct. 1026, 1029 (1989). Application of subsection (a) results in a bifurcation of previously secured claims. It provides that a claim is secured only to the extent of the value of the property which serves as collateral. The remainder of the claim, up to the amount of the original obligation, is unsecured. *Id.*; *see also* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 5, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6312.

In interpreting these provisions, we begin by recognizing, as the bankruptcy court did, that the trustee abandoned this property pursuant to section 554 of the Code. That section allows abandonment of property that "is burdensome to the estate or that is of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a). Property abandoned under this section ceases to be part of the estate. *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 5, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6299. ("Property ceases to be property of the estate, such as by sale, abandonment, or exemption."). It reverts to the debtor and stands as if no bankruptcy petition was filed. *See Brown v. O'Keefe*, 300 U.S. 598, 602 (1937); *Wallace v. Lawrence Warehouse Co.*, 338 F.2d 392, 394 n.1 (9th Cir. 1964); *Dewsnup*, 87 Bankr. at 681. Following abandonment, "whoever had the pos-

sessory right to the property at the filing of bankruptcy again reacquires that right." *Dewsnup*, 87 Bankr. at 681. Abandoned property is *not* property administered by the estate. Recognition of this principle is essential in considering whether debtors may void these liens.

Pursuant to the plain language of section 506(a), an allowed claim of a creditor is one in *which the estate has an interest.* It is "a secured claim to the extent of the value of such creditor's interest *in the estate's interest* in such property. . . ." Here, debtors argue that because an allowed secured claim is limited to the value of the collateral under 506(a), they may completely redeem the property and retain possession by paying creditors the property's fair market value.

This analysis overlooks the fundamental premise of the language contained in this section. In order to apply section 506(a), the estate must have an interest in the property. The estate has no interest in, and does not administer, abandoned property. In *In re Maitland*, the court stated:

> The difficulty this section presents is that § 506(a) seems limited in its application to "property in which the estate has an interest," and it is clear that if the property never has been property of the estate or if property has been abandoned by the trustee as an asset of the estate, the estate does not have an interest which would allow for a § 506(a) determination.

61 Bankr. 130, 132-33 (Bankr. E.D. Va. 1986). Consequently, debtors cannot void these liens. This assessment is consistent with our examination of statutory language generally. As we have stated, when statutory language is clear, "it is conclusive 'absent a clearly expressed legislative intent to the contrary.'" *Miller v. Commissioner*, 836 F.2d 1274, 1283 (10th Cir. 1988) (quoting *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). Because abandoned property is not property in which the estate has an interest, section 506(a) does not apply.

In the *Gaglia* case, the Third Circuit rejected this reasoning, concluding:

> If § 506(a) is so interpreted, it would seem to conflict with the plain meaning of § 506(d). Moreover, when a debtor files a Chapter 7 petition, all of his right and title to property, legal as well as equitable, passes to the estate. This includes the legal title to property secured by a mortgage. Thus, even though the Gaglias had no equity in the property, the estate had an interest in it.

889 F.2d at 1308 (citations and footnote omitted).

We reject this approach for two reasons. First, we reject the notion that section 506(d) must be read in isolation. It is a fundamental precept of statutory construction that "[i]n expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Mastro Plastics Corp. v. NLRB*, 350 U.S. 270, 285 (1956) (quoting *United States v. Boisdore's Heirs*, 8 How. 113, 121 (1850)).

Second, the Third Circuit's rationale does not adequately recognize the affect of abandonment with its resulting consequences, including reversion of the property to pre-bankruptcy status. The reasoning in *Gaglia* might apply if the language in the statute was "property of the estate" rather than "property in which the estate has an interest." It is true that pursuant to 11 U.S.C. § 541, all property in which the debtor has a legal or equitable interest becomes part of the bankruptcy case at the time a petition is filed. *See In re Harvey*, 3 Bankr. 608, 609 (Bankr. M.D. Fla. 1980). In this case, however, the operative phrase is "interest of the estate." Following abandonment, the estate no longer has an interest, even though

it did at one time. To construe this section otherwise would defeat the purpose behind the abandonment provision and run counter to the plain language of the Code.

In keeping with this analysis, we join those courts which have concluded that the language used in sections 506(a) and (d) was intended to facilitate valuation and disposition of property in the reorganization chapters of the Code. In *Shrum*, the court provides a cogent analysis of the intended purpose of section 506(a). It states:

> It is common in Chapter 12 and 13 cases for debtors to propose plans which deal with and affect abandoned and/or exempted property, such as real property occupied as the homestead and motor vehicles intended for personal use. In such cases, even though the property may no longer be "property of the estate", it nevertheless remains "property in which the estate has an interest." Plan proponents in Chapter 12 and 13 cases, and, if applicable, in Chapter 11 cases as well, must therefore be permitted to employ § 506(a) in conjunction with the proposed impairment or modification of the rights of the holders of secured claims . . . . Congress has provided numerous incentives to debtors choosing reorganization or rehabilitation under Chapters 11, 12 or 13, rather than liquidation under Chapter 7. It is believed that the availability of § 506 in connection with plans under those chapters which deal with exempt or abandoned property is simply another such incentive.

98 Bankr. at 1001. The plain language of the statute, coupled with the abandonment provision of the code, indicate Congress did not intend to allow Chapter 7 debtors to use section 506(d) to retain abandoned property.

Our assessment that 506(d) does not apply to debtors' property is bolstered further through review of the creditors rights provisions found in Chapters 12 and 13. Pursuant to 11 U.S.C. § 1322(B)(2), a Chapter 13 plan may

not modify the rights of secured claim holders where the claim is secured only by a security interest in real property which is the debtor's primary residence. Likewise, in 11 U.S.C. § 1111(b)(2), the Code allows creditors in a Chapter 11 case to make an election which would result in allowing a secured lien to remain on the property to the full extent of the original obligation.

Reconciliation of these provisions with the language of section 506 mandates the result which we reach in this case. Congress has manifested a strong preference for reorganization rather than liquidation in the bankruptcy setting. *See Maitland*, 61 Bankr. at 135 (recent revisions to the Bankruptcy Code evidence Congress' intent to "steer debtors who are eligible for Chapter 13 away from Chapter 7"). It is inconsistent with this preference to allow debtors more in a liquidation than they would receive in a reorganization.

11 U.S.C. § 722, the Code's redemption provision, is also instructive. It states:

> § 722. *Redemption*
>
> An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

This section constitutes the only redemption provision provided for Chapter 7 debtors. Notably, it only pertains to personal property. In *Maitland*, the court correctly identified the problem when it stated: "In light of the exclusion of real property in § 722, and its express limitation to specific tangible personal property, it is obvious that Con-

gress did not intend to permit a debtor to redeem his real property through the use of § 506(d)." 61 Bankr. at 135.

Here, debtors seek to do exactly what section 722 provides, except with respect to real property. In *Gaglia*, the court correctly noted that section 506 is not a redemption provision. 889 F.2d at 1310. However, the rationale of that case mandates that it become one. The *Gaglia* court distinguished section 506 from section 722 by stating, "the Gaglias will not own the property unencumbered. They will still be subject to First Federal's mortgage and the SBA's claim to the extent it is secured. . . . We do not believe any arguable redundancy in §§ 506 and 722 precludes the application of § 506 here." *Id.* Using the same rationale that *Gaglia* and its progeny embrace, debtors here would own their property outright.[3] Under these circumstances, section 506 *would* be used as a redemption provision. This result is both inequitable and unfair and would constitute an expansion of debtors rights far beyond what is contemplated in the Code.

Those courts allowing avoidance have generally dismissed this fairness argument by assuming that avoidance merely duplicates what would transpire in a liquidation. *See Gaglia*, 889 F.2d at 1308. This assumption overlooks those situations where creditors can use an appreciation in land values to offset their losses at a forced sale following foreclosure.

Outside the bankruptcy setting, it is highly unlikely that a debtor would retain his property in the circumstances presented here. Rather, creditors would probably foreclose and prompt a forced sale. At that sale, a senior lienholder could purchase the property and sell it at some later time in anticipation of a change in land values. If there were two or more claims or mortgages, the junior lienholder could purchase the property, pay the senior lienholder, then inventory the property for later sale in hope of decreasing the amount of loss. In today's real estate market, these are very real considerations. Allowing section 506 relief denies creditors these options. The flaw in the majority's position is the assumption that a third party unrelated to the transaction will purchase the property at a forced sale, thus prohibiting lienholders from reaping the benefits of an appreciation in land values. In today's complex real estate markets, this is not a valid assumption.

[3] Our disposition in this case does not alter the availability of any state law remedies which debtors may have.

Allowing lien avoidance under section 506(d), or in this case, complete redemption, gives debtors much more than the "fresh start" to which they are entitled. We do not believe Congress intended such a result when it enacted these Code provisions.

Consequently, the judgment of the United States District Court for the District of Utah is AFFIRMED.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

Bankruptcy No. 84C-01746
(Chapter 7)

Adversary No. 87PC-0116

District No. 88C-0841G

LAMAR DEWSNUP, ALETHA DEWSNUP,
Appellants,

vs.

LOUIS L. TIMM, *et al.*,
Respondents.

ORDER AFFIRMING JUDGMENT OF
BANKRUPTCY COURT

[Filed Mar. 16, 1989]

Debtor's appeal of the Memorandum Decision of the United States Bankruptcy Court and subsequent Judgment of Dismissal of their Adversary Proceeding with prejudice by the Honorable Judge Glen E. Clark came on for hearing before this Court on Thursday, March 2, 1989, at the hour of 4:30 p.m.; Debtor/Appellants were represented by their counsel Scott C. Pierce of McKay, Burton & Thurman and Defendants/Respondents were represented by their counsel Michael Z. Hayes of the firm of Mazuran, Verhaaren & Hayes, and the Court having reviewed the record in this proceeding including the Memorandum Decision of Judge Clark and having reviewed the appeal briefs and having heard the oral argument of counsel and being fully advised in the premises and good cause appearing therefore, it is hereby

ORDERED, ADJUDGED AND DECREED as follows:

1. The Judgment of Dismissal, dismissing with prejudice, Debtor's adversary proceeding in this matter is hereby affirmed.

DATED this 15 day of March, 1989.

Copies mailed to cnsl 3/16/89mp:

William Thomas Thurman, Esq.
Michael Z. Hayes, Esq.
Marilyn Weaver, Bankruptcy

/s/ Judge J. Thomas Green, Jr.
JUDGE J. THOMAS GREEN, JR.
U.S. District Court Judge

Approved as to form:

/s/ Scott C. Pierce
SCOTT C. PIERCE
Attorney for Debtor/Appellants

MAILING CERTIFICATE

I hereby certify that I mailed a true and correct copy of the foregoing ORDER AFFIRMING THE JUDGMENT OF THE U.S. BANKRUPTCY COURT by first class mail, postage prepaid, to Scott C. Pierce, attorney for Debtor/Appellants, Suite 1200 Kennecott Building, 10 East South Temple Street, Salt Lake City, Utah 84133, this 6th day of March, 1989.

/s/ Michael Z. Hayes

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH

Bankruptcy Case 84C-01746

Civil Proceeding No. 87PC-0116

IN RE: LAMAR DEWSNUP and ALETHA DEWSNUP,
Debtors.

LAMAR DEWSNUP and ALETHA DEWSNUP,
Plaintiffs,

vs.

LOUIS L. TIMM, *et al.*,
Defendant.

JUDGMENT OF DISMISSAL

Plaintiffs' Adversary Proceeding came on for hearing before the Honorable Glen E. Clark on Thursday, June 25, 1987, at 9:00 o'clock a.m. Plaintiffs were represented by William Thomas Thurman and Scott C. Pierce of McKay, Burton & Thurman, Salt Lake City, Utah. Defendants were represented by Michael Z. Hayes of Mazuran, Verhaaren & Hayes, Salt Lake City, Utah. The Court, after having reviewed the file and having heard testimony from the parties and after having taken the matter under advisement and subsequently filing its published Memorandum Opinion, which is incorporated into this Order by reference, hereby Orders, Adjudges and Decrees as follows:

1. Plaintiffs' Adversary Proceeding is dismissed in its entirety with prejudice;

2. All parties are to bear their own costs.

DATED this 15th day of August, 1988.

/s/ Judge Glen E. Clark
JUDGE GLEN E. CLARK
United States Bankruptcy Court
Chief Judge

MAILING CERTIFICATE

I hereby certify that I mailed a copy of the foregoing Judgment of Dismissal to the following this 17th day of August, 1988.

William Thomas Thurman, Esq.
Scott C. Pierce, Esq.
MCKAY, BURTON & THURMAN
Suite 1200 Kennecott Building
Salt Lake City, Utah 84133

Michael Z. Hayes
MAZURAN, VERHAAREN & HAYES
Parkview Plaza, Suite 260
2180 South 1300 East
Salt Lake City, Utah 84106

Secretary to Judge Clark

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH

Bankruptcy Case No. 84C-01746

Civil Proceeding No. 87PC-0116

IN RE LAMAR DEWSNUP and ALETHA DEWSNUP,
Debtors.

LAMAR DEWSNUP and ALETHA DEWSNUP,
Plaintiffs,

v.

LOUIS L. TIMM, *et al.*,
Defendants.

MEMORANDUM OPINION

Appearances: William Thomas Thurman and Scott C. Pierce of McKay, Burton & Thurman, Salt Lake City, Utah, for the Plaintiffs. Michael Z. Hayes of Mazuran, Verhaaren & Hayes, Salt Lake City, Utah, for the Defendants.

This is an action to determine the validity and extent of a trust deed on real property. The Plaintiffs' amended complaint alleges that "[t]he security interests of the Defendants can be satisfied in full by Plaintiffs remitting to the Defendants the fair market value of the property upon which the security interest attaches." At the time of trial of this matter, the Court valued the real property subject to the Defendants' security interest at $39,000.00. The Court then took the matter under advisement for the sole purpose of resolving the issue of whether the debtors in this Chapter 7 case may "redeem" real property, which has been or may be abandoned to

them,[1] by paying to the secured creditors the fair market value of the property.

The debtors argue that pursuant to 506(d) of the Bankruptcy Code, a lien is void to the extent it does not secure an "allowed secured claim." Since an "allowed secured claim" is limited to the value of the collateral pursuant to § 506(a), then they should be allowed to simply pay to the Defendants the value of the real property and take the property free and clear of any security interest which the Defendants might assert.

The Defendants, on the other hand, argue that to allow the debtors to redeem real property under § 506(d)

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[1] There is no evidence before the Court as to whether this real property has been abandoned to the debtors or whether the trustee intends to do so. However, this adversary proceeding only states a cause of action if the property is abandoned. Otherwise, the debtors would have no standing to assert their claim to avoidance and redemption and the property would be liquidated by the Chapter 7 trustee, making these matters moot. Although some courts have allowed Chapter 7 debtors to avoid liens pursuant to § 506(d) even though the property had not been abandoned to them, *see, e.g., In re Crouch*, 76 B.R. 91 (Bkrtcy. W.D. Va. 1987), in this case the debtors ask the Court to authorize them to pay the fair market value of the property to the secured creditor and then take title to the property free and clear of liens. That request can only make analytical sense in conjunction with an abandonment from the trustee, either pursuant to § 554(a) or (b) (upon the filing and granting of an appropriate motion for abandonment), or as a result of the operation of § 554(c) (deeming property "not otherwise administered" to be abandoned at the time of the closing of the case). Although the debtors have claimed a homestead exemption in the Oak City property, it is clear from this proceeding that they have no interest in the property by virtue of that claim since there is no equity to which the exemption might attach. *See, Wilson v. General Motors Acceptance Corporation (In re McCoy)*, 643 F.2d 684 (10th Cir. 1981); *Styler v. Local Loan Financial Services (In re Lanctot)*, 6 B.R. 576 (Bkrtcy. D. Utah 1980). Moreover, the trustee of this estate has neither been made a party to this action, nor has he been served with any of the pleadings. Therefore, for the purpose of this opinion, the Court will assume that the real property has been or will be abandoned to the debtors.

would make § 722 (which deals specifically with redemption in Chapter 7 cases) a superfluous provision. They contend that although the provisions of § 506 apply generally in Chapter 7 cases, *see*, § 103(a), principles of statutory construction dictate that the more specific provision (here § 722) should take priority over the general Chapter 5 provision.

Section 506 provides in pertinent part:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.
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> * * * *
>
> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless—
>
> (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
>
> (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

Section 722 provides:

> An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

Courts which have considered the interplay between these provisions of the Code are divided on the issue of whether a Chapter 7 debtor may utilize § 506(d) to avoid the undersecured portion of a lien on real property which has or will be abandoned to it and whether such a debtor may pay a secured creditor the fair market value of such real property in full satisfaction of the lien. The leading case allowing such avoidance pursuant to § 506(d) is *In re Tanner*, 14 B.R. 933 (Bkrtcy. N.D. Penn. 1981). *See also, In re Walker*, 11 B.R. 43 (Bkrtcy. N.D. Ill. 1981); *In re Brace*, 33 B.R. 91, 93-94 (Bkrtcy. S.D. Ohio 1983); *In re Bracken*, 35 B.R. 84 (Bkrtcy. E.D. Penn. 1983); *In re Gibbs*, 44 B.R. 475, 478-479 (Bkrtcy. D. Minn. 1984); *In re Lyons*, 46 B.R. 604 (Bkrtcy. N.D. Ill. 1985); *In re Cleveringa*, 52 B.R. 56 (Bkrtcy. N.D. Iowa 1985); *In re Lindsey*, 64 B.R. 19 (Bkrtcy. C.D. Ill. 1986); *In re Worrell*, 67 B.R. 16 (C.D. Ill. 1986); *In re O'Leary*, 75 B.R. 881 (Bkrtcy. D. Oregon 1987); *In re Gaglia*, 76 B.R. 82 (Bkrtcy. W.D. Penn. 1987); and *In re Crouch*, 76 B.R. 91 (Bkrtcy. W.D. Va. 1987).

In *Tanner*, the debtor had filed an action requesting the court to declare a third mortgage unsecured and, therefore, void under § 506. The defendant argued that Congress did not intend real property mortgages to be voidable and that "lien" as used in § 506(d) does not refer to a lien of a mortgage on real property. In rejecting that argument, the court recognized the broad definition of "lien" under § 101, and stated:

> It is unlikely that Congress would define a lien broadly and then use the word in a narrower sense without so indicating. Further indications of Congressional intent that a real property mortgage is included within the meaning of lien in Section 506(d) are apparent from language elsewhere in the Code. . . . [Specific] terms are used throughout the Code indicating Congress knew how to designate subspecies

> of lien when it is so desired. In addition, Congress has demonstrated that when it desired to single out a real property mortgage for special treatment, it will clearly so indicate. An example is Section 1322 (b) (2) [.]

14 B.R. at 935. Moreover, the court reasoned that § 506 (d) must be construed "in light of the definitional section, Section 506 in its entirety, and the overall scheme of the Code . . . ." *Id.* at 936. In so analyzing the applicable provisions the court concluded that if the undersecured portion of a real property mortgage is not avoidable, a prepetition creditor will impair the debtor's fresh start by partaking in his postpetition property acquisitions, which here includes the postpetition appreciation of real property.

Finally, the court concluded that the bankruptcy procedure was designed to put the debtor and its creditors in the same position they would be if the property had been sold at a non-bankruptcy forced sale on the petition date:

> At a forced sale the Debtor does not retain title to the property and the overvalued lien holder would not gain from future appreciation or increases in the equity. The Defendant's argument requires attributing to Congress an intent to benefit the real property mortgage holder more under a bankruptcy proceeding than under a non-bankruptcy forced sale. Clearly that is not consistent with the intent of Congress in providing for Debtor "relief" under the Bankruptcy Code.

14 B.R. at 937.

The leading cases which have rejected *Tanner* and its progeny and have refused to allow Chapter 7 debtors to avoid the undersecured liens on abandoned real property are *In re Mahaner*, 34 B.R. 308 (Bkrtcy. W.D. N.Y. 1983) and *In re Maitland*, 61 B.R. 130 (Bkrtcy. E.D. Va. 1986). *See also, In re Cordes*, 37 B.R. 582 (Bkrtcy. C.D.

Calif. 1984); *In re Gaglia*, 76 B.R. 82 (Bkrtcy. W.D. Penn. 1987); *In re Smith*, 79 B.R. 650 (Bkrtcy. D. Md. 1987). In addition, certain of the courts which have felt compelled by their reading of the language of § 506(d) to follow *Tanner* have expressed serious reservations about the result. *See, In re Lyons*, 46 B.R. 604, 606-607 (Bkrtcy. N.D. Ill. 1985) ("This problem is a difficult one from a policy perspective because of the apparent divergence here between the law and one's sense of what is equitable. On the one hand, as other courts have noted, the relevant question is what the lienholders' interests would be outside bankruptcy. That is, what each lienholder would receive in a foreclosure should also be the worth of his lien in the bankruptcy setting. On the other hand, it seems manifestly unfair to permit a debtor to retain his house after avoiding liens to the extent they exceed the value of the collateral. As of this time, however, that result seems to be the one which the Code compels."); *In re Worrell*, 67 B.R. 16, 20 (C.D. Ill. 1986) ("Even though the Court is holding that a Chapter 7 debtor may use § 506(d) to avoid the operation of real estate mortgage lien upon his property to the extent that the lien exceeds the value of the property, the Court finds this result unfair and difficult to accept. As the Court said in *Lyons*, '[I]t seems manifestly unfair to permit a debtor to retain his house after avoiding liens to the extent they exceed the value of the collateral.' 46 B.R. at 606-07. This is a difficult problem from a policy perspective because of the Court's sense of what is right and equitable. Nevertheless, the bottom line is that this is a question which Congress should address because the Court cannot rewrite this section of the Bankruptcy Code, and the result reached today appears to be the one which the Code compels.").

In *In re Mahaner*, an undersecured junior mortgage holder moved the court for relief from the automatic stay. In response, the debtors filed a motion under § 506 for a valuation of the real property and indicated their

intention to redeem the property by paying the creditor the amount of its interest in the property. In rejecting the debtor's theory, the court articulated three reasons why § 506(d) may not be used by the debtor to avoid a mortgage lien in a Chapter 7 case: "First, it would appear that to permit lien avoidance . . . would render 11 U.S.C. § 722 totally surplus. . . . A fundamental rule of statutory construction is that a specific statute prevails over an ambiguous or even an inconsistent general statute." 34 B.R. at 309. Second, the court observed that it is not good policy to allow a debtor to get in Chapter 7 more than he could in Chapter 11 or 13. In Chapter 13, § 1322(b)(2) prohibits the debtor from modifying a lien on real property if the property is his principal residence. In Chapter 11, the creditor would be able to make an election pursuant to § 1111(b) to be treated as though he were fully secured, thereby protecting his interest in the appreciation of the real property. Parenthetically the court noted that in its view the "more likely policy of the void language of 11 U.S.C. § 506(d) is that it was intended to permit a sale of the collateral by a trustee or the debtor-in-possession to extinguish the entire lien even though it is at a price insufficient to satisfy the debt in full." *Id.* Third, the court held that such an application of § 506(d) would amount to an unconstitutional taking of a property interest. The court noted that the creditor's right to appreciation in the value of its collateral was a property interest which could not be taken from it without just compensation.

In *In re Maitland*, 61 B.R. 130 (Bkrtcy. E.D. Va. 1986), the debtors commenced an adversary proceeding (1) to determine the extent of allowed secured claims against their real property under § 506(a); and (2) to avoid liens against the property to the extent that liens were undersecured, pursuant to § 506(d). The Court commenced its analysis by noting the relationship and interdependence of § 506(a) and § 506(d):

> The difficulty this section presents is that § 506(a) seems limited in its application to "property in which the estate has an interest," and it is clear that if the property never has been property of the estate or if property has been abandoned by the trustee as an asset of the estate, the estate does not have an interest which would allow for a § 506(a) determination. In contrast, § 506(d) provides that "to the extent that a lien secures a *claim against the debtor* that is not an allowed secured claim, such lien is void. . . ."
>
> * * * *
>
> One must refer to § 506(a) to find that an allowed secured claim is a secured claim only to the extent of the value of such secured creditor's interest in the *estate's interest* in such property.
>
> * * * *
>
> [Section] 506(a) is intended to value claims against property which is going to be administered under the Code, not property abandoned or released.

61 B.R. at 132-133 (emphasis in original). *See also, In re Harvey*, 3 B.R. 608 (Bkrtcy. M.D. Fla. 1980) ("[Section 506(a)] was intended to deal with properties of the estate which are being administered under the Code and not to deal with properties which were released as exempt or abandoned."). The court then concludes that § 506(a) may not be used to bifurcate a claim for § 506(d) purposes when property is abandoned to a Chapter 7 debtor:

> Section 506(a) does not contemplate determining the extent to which a claim is allowed for lien avoidance purposes under § 506(d) if the property has been abandoned. If the property is not to be administered as an asset of the estate for liquidation, or for retention by the debtor-in-possession in a Chapter 11 reorganization or a Chapter 13 wage-earner plan, then determination as to the extent a

> claim is an allowed secured claim serves no statutory purpose, other than as specifically provided under § 722.

Id. at 134. The court also noted that if *Tanner* and its progeny were to be followed, § 722 would be rendered meaningless:

> Section 722, however, does not allow the debtor to redeem *real property* by paying the holder of an allowed claim secured by the abandoned or exempted property the secured amount of the claim. Such a result would occur if the debtor could pay the secured creditor with a lien against the debtor's abandoned or exempted real estate an amount equal to the value of the property and then, under § 506 (d), void the lien to the extent that it is undersecured. In light of the exclusion of real property in § 722, and its express limitation to specific tangible personal property, it is obvious that Congress did not intend to permit a debtor to redeem his real property through the use of § 506(d).

Id. at 135.

As did the courts in *Lyons* and *Worrell*, *supra*, this Court believes the result in *Tanner* to be unfair and inequitable. However, we do not believe, as did those courts, that such a result is compelled by the language of the Code.

To resolve the issues before the Court it is necessary to understand the rights of debtors and their creditors in property which is abandoned under § 554. Section 554 allows a trustee to abandon property which is burdensome to the estate or which is of inconsequential value. When property is properly abandoned by the trustee, the property is no longer property of the estate and the estate, consequently, has no interest in the property. *See*, H.R. Rep. No. 95-595, 95th Cong., 1st Sess., at 343 (1977), U.S. Code Cong. & Admin. News 1978, p. 6299

("property ceases to be property of the estate, such as by sale, abandonment, or exemption."); *In re Cruseturner*, 8 B.R. 581 (Bkrtcy. D. Utah 1981).

In the *Cruseturner* case this Court also examined the rights of the parties vis-a-vis the property following an abandonment:

> The state of the law under the former Act appears to be that title to all property abandoned by the trustee stood as if no bankruptcy had been filed, which in most cases meant it revested in the debtor. Justice Cardozo aptly expressed this rule in *Brown v. O'Keefe*, 300 U.S. 598, 602, 57 S.Ct. 543, 546, 81 L.Ed. 827 (1937):
>
> > Whatever title or inchoate interest may have passed to the trustee was extinguished by relation as of the filing of the petition when the trustee informed the court that the shares were burdensome assets, and was directed by the court to abandon and disclaim them. In such case "the title stands as if no assignment had been made." A precise analogy is found in the law of gifts and legacies. Acceptance is presumed, but rejection leaves the title by relation as if the gift had not been made. (Citations omitted.)

In *Wallace v. Lawrence Warehouse Company*, 338 F.2d 329, 394 n. 1 (9th Cir. 1964), the Ninth Circuit emphasized the widespread acceptance of this general position:

> The ordinary rule is that, when a trustee abandons property of the bankrupt, title reverts to the bankrupt, nunc pro tunc, so that he is treated as having owned it continuously. (Citations omitted).

See also Sessions v. Romadka, 145 U.S. 29, 112 S.Ct. 799, 36 L.Ed. 609 (1892); *Sparhawk v.*

Yerkes, 142 U.S. 1, 12 S.Ct. 104, 35 L.Ed. 915 (1891); *In re Garfinkle*, 577 F.2d 901 (5th Cir. 1978); *In re Ira Haupt & Co.*, 398 F.2d 607 (2d Cir. 1968); *Brookhaven Bank & Trust Co. v. Gwin*, 253 F.2d 17 (5th Cir. 1958); *Colson v. Monteil*, 226 F.2d 614 (8th Cir. 1955); *Rosenblum v. Dingfelder et al.*, 111 F.2d 406 (2d Cir. 1940); *In re Moss et al.*, 21 F.Supp. 1019 (E.D. Ill. 1938).

This analysis appears to be equally appropriate to the present law. Section 554 deals with the abandonment of property. Both the House and Senate reports, in explanation of the effect of the section state:

> Abandonment may be to any party with a possessory interest in the property abandoned. In order to aid administration of the case, subsection (b) deems the court to have authorized abandonment of any property that is scheduled under Section 521(1) and that is not administered before the case is closed. That property is deemed abandoned to the debtor.

H.R. Rep. No. 95-595, *supra*, at 377; S.Rep. No. 95-989, *supra* at 92, U.S. Code Cong. & Admin. News 1978, pp. 5878, 6333. Subsection (b), enacted as Section 554(c), was changed in the final draft by deleting references originally made which stated that abandonment under this section would be made specifically to the debtor. Thus, it appears that abandonment under any subsection of 554 will be to a party with a "possessory interest." Generally, a "possessory interest" is defined as a "right to exert control over" or a "right to possess" property "to the exclusion of others." BLACK'S LAW DICTIONARY 1049 (5th ed. 1979). This legislative reference and attendant definition are in keeping with cases under former law which hold that title and right to the property reverts to its pre-bankruptcy status. Thus,

> whoever had the possessory right to the property at the filing of bankruptcy again reacquires that right. Normally this party is the debtor, but it is conceivable that a creditor may be entitled to possession instead if, by the exercise of its contractual or other rights, it held a possessory interest prior to the filing of bankruptcy.
>
> • • • •
>
> *Thus, when the trustee abandons property, the property stands as if no bankruptcy had been filed and the debtor enjoys the same claim to it and interest in it as he held previous to the filing of bankruptcy.*

8 B.R. at 590-591 (emphasis supplied).

The confusion which has arisen over the meaning of § 506(d) is due to the application of the language of that section in isolation from its intended role in the distribution scheme of the Bankruptcy Code. Subchapter I of Chapter 5 of the Code governs the filing, allowance, priority, and distribution of claims of creditors through a bankruptcy proceeding. Section 501 governs the filing of proofs of claims. Section 502(a) provides that a claim will be deemed "allowed" if a proof of claim is properly filed, to which no party in interest objects. If an objection is filed, the Court, based on the provisions of § 502(b), will make a judicial determination whether the claim of the creditor will be "allowed" or "disallowed." Similarly, § 503 governs the allowance of administrative expense claims. The purpose of this procedure is to determine which claims of creditors may participate in the distribution of the estate under a Chapter 7 liquidation or which claims may participate in a plan under Chapters 9, 11, 12, or 13. Creditors are not required to file proofs of claim and debts are discharged whether claims are allowed or not. *See*, § 501(a) and §§ 727(b), 1141(d), 1228(a) and 1328(a). Fi-

nally, general provisions of distribution are set forth in § 507 (priority of distribution) and §§ 509 and 510 (governing subrogation and subordination of certain claims).

In a case under Chapter 7, a trustee is charged with the duty to "collect and reduce to money the property of the estate." § 704(1). Distributions are then made to secured creditors pursuant to § 725, and unsecured creditors pursuant to the priority scheme set forth in §§ 507 and 726. In addition to these provisions, § 522 allows an individual debtor to exempt certain property from the property of the estate and § 554 allows the trustee to abandon property which is burdensome to the estate or that is of inconsequential value. The resulting effect of the latter two provisions in a Chapter 7 case is to exclude certain property from the liquidation and distribution process. It is within this scheme of allowance and distribution that § 506(a) provides that "[a]n allowed claim of a creditor secured by a lien on property *in which the estate has an interest* . . . is a secured claim to the extent of the value of such creditor's interest *in the estate's interest in such property*, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim." (Emphasis supplied). To facilitate the distribution and participation in the bankruptcy process, the Code splits an allowed claim secured by property of the estate into a secured portion, which is denominated as an "allowed secured claim," and unsecured portion which will be treated as an "allowed unsecured claim." By definition, a creditor may only possess an allowed secured claim if it has a lien on property of the estate and it is an allowed secured claim only to the extent of the value of that interest.

The purpose of this provision, in the Court's view, is to limit the preferential position of a secured creditor in bankruptcy to the extent to which such a creditor

would be able to look to its collateral for satisfaction of its debt. Only holders of allowed secured claims are entitled to reject a plan and be protected under cramdown provisions of Chapters 12 or 13. Holders of allowed secured claims in Chapter 11 cases are entitled to retain their liens and receive cash payments under the plan having a present value equal to the value of their interest in the collateral, or to otherwise realize "the indubitable equivalent" of their secured claim. *See*, §§1126(a), 1129(b)(2)(A), 1225(a)(5), 1325(a)(5). Only creditors with allowed secured claims may make a § 1111(b) election. The proceeds from the liquidation of a Chapter 7 estate are paid first to creditors holding allowed secured claims. § 724(a)(1).

To fully effectuate this dichotomy of the protection and distribution of allowed secured claims and allowed unsecured claims under the Bankruptcy Code, § 506(d) provides that a lien is void if it secures a claim that is not an allowed secured claim. To underscore this statutory scheme, § 551 provides that a lien void under § 506(d) is preserved for the benefit of the estate.

It is inconceivable to this Court that Congress could have intended to create an avoiding power in a Chapter 7 debtor, respecting property which is not to be administered through the bankruptcy process, and which is based on a dichotomy created to facilitate the administration and distribution of the bankruptcy estate.

Since the rights in property which is abandoned remain the same as if no bankruptcy had been filed, *Cruse-turner*, *supra*, it would be illogical to allow the debtors by virtue of § 506(d) to avoid a lien which they could not avoid outside of bankruptcy. Upon abandonment, the debtor must bear the burdens as well as the rights which it previously possessed. In *Tanner*, Judge Cosetti acknowledges that pre-bankruptcy law is the appropriate paradigm to apply in abandonment cases. He reasons:

> The Code scheme of Section 506 is that creditors receive through the valuation procedure of the Bankruptcy Court the same property value that they would receive through a non-bankruptcy forced sale of the Debtor's non-exempt assets as of the petition date. . . . The operation of Section 506(d) merely effectuates the market place.

14 B.R. at 936-937. However, to concentrate exclusively on the debtor's fresh start, as did the *Tanner* court, at the expense of the property rights of creditors is a misguided approach. At a forced sale of real property, the debtors would not retain title to the property as would the debtors here, unless they were to purchase at the sale. If the secured creditor or a third party were to purchase, any appreciation in the value of the property would inure to the benefit of that party and not to the debtors. Moreover, since the timing of a trustee's sale is in the control of the secured creditor, an undersecured creditor can, if it so chooses, defer sale of the property until it has realized any possible benefit from appreciation. In addition, the ~~secured~~ creditor could simply bid in the amount of its debt at the sale and thereby control the amount of the sales price as well as the timing of the sale. Therefore, even if the debtors were willing and able to purchase at a forced sale, as these debtors now claim to be, they could not compel such a result on an objecting secured creditor, since the timing of the sale and the amount of sales price is in the latter's control. Finally, pursuant to this Court's analysis, if the debtors have such remedies under Utah state law, they may now employ them. However, we conclude that § 506(d) does not grant any additional rights to the debtors in abandoned property than they would have had under prepetition nonbankruptcy law.

The approach suggested by the Court does not impede the debtors' fresh start. They can give up their interest in the property and obtain their fresh start. Moreover,

any deficiency claim is clearly within the scope of the debtors' discharge. However, in this case the debtors are attempting to get more than a fresh start. The debtors want to keep their property and be entitled to the future appreciation in the value of the real property without paying the full amount of the obligation secured by the lien. That is something to which they would not be entitled at a forced sale of the property. Absent abandonment, it is also something they would not be entitled to in a bankruptcy proceeding. Pursuant to § 551, any interest or value arising out of an avoidance under § 506(d) would be preserved for the benefit of the estate and creditors with claims against it.

CONCLUSION

For the reasons set forth herein, the Court holds that a Chapter 7 debtor may not utilize § 506(d) to avoid the undersecured portion of a lien on property which is exempt or which has or will be abandoned by the trustee. The avoiding power of that section is limited to property which is property of the estate and is administered by the trustee.

DATED this 15 day of June, 1988.

BY THE COURT:

/s/ Glen E. Clark
GLEN E. CLARK
Chief Judge
United States Bankruptcy Court

CERTIFICATE OF MAILING

I hereby certify that I mailed a copy of the foregoing Memorandum Opinion to the following this 16 day of June, 1988.

William Thomas Thurman, Esq.
Scott C. Pierce, Esq.
McKAY, BURTON & THURMAN
Suite 1200, Kennecott Building
Salt Lake City, Utah 84133

Michael Z. Hayes, Esq.
MAZURAN, VERHAAREN & HAYES
Parkview Plaza, Suite 260
2180 South 1300 East
Salt Lake City, Utah 84106

/s/ [Illegible]
Secretary to Judge Clark

(2)

No. 90-741

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

RICHARD G. TARANTO
(Counsel of Record)
ONEK, KLEIN & FARR
2550 M Street, N.W.
Suite 350
Washington, D.C. 20037
(202) 775-0184

MICHAEL Z. HAYES
MAZURAN, VERHAAREN & HAYES
2180 South 1300 East
Suite 260
Salt Lake City, UT 84106

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

STATEMENT

Petitioner owes money to respondents. As security for the debt, respondents have a lien on certain non-resident farmland, a lien that, under Utah law and the security agreement, gave respondents a right to proceed against the property when petitioner defaulted. Petitioner argues that Section 506 of the Bankruptcy Code, 11 U.S.C. § 506, strips respondents of their state-law property right to enforce their lien, even though the farm parcels have been abandoned by the bankruptcy trustee and therefore play no role in this liquidation proceeding.

1. Petitioner, together with her now-deceased husband, executed a deed of trust on June 1, 1978, conveying two farm parcels to a trustee as security for $119,000 in loans. Neither parcel is petitioner's principal residence. Respondents, as the lenders, are the beneficiaries of the trust.[1]

The deed of trust is governed by Utah law. The deed states that, if the borrowers defaulted on their obligations, respondents were entitled to declare the full amount due, to issue a notice of default, and (after an appropriate interval) to have the parcels sold at public auction to the highest bidder, with the proceeds to satisfy the debt owed to respondents (as well as certain other expenses). Deed of Trust ¶¶ 14, 15. Those provisions are mirrored in Utah statutes. Utah Code Ann. §§ 57-1-20 to 57-1-37 (1990).

Petitioner defaulted in 1979.[2] Respondents exercised their rights under the deed of trust and, pursuant to Utah law, gave petitioner 90 days to cure the default, which petitioner failed to do. *See* Utah Code Ann. § 57-1-24. In a state court action, respondents obtained a judgment confirming petitioner's remaining debt to respondents. II R.O.A. 45, 50. Respondents thereupon gave notice of a non-judicial sale to enforce their lien.

In April 1981, before the sale could take place, petitioner filed for bankruptcy protection, seeking reorganization under Chapter 11 of the Bankruptcy Code. That filing stayed the property sale. 11 U.S.C. § 362. Although the 1981 petition was dismissed in 1982, and a second Chapter 11 petition was dismissed in 1984, petitioner filed the present bankruptcy action in 1984 seeking

[1] ABCO Insurance Agency is the only corporation among the respondents. Pursuant to Sup. Ct. Rule 29.1, respondents hereby state that ABCO has no parent company and no subsidiaries except wholly owned subsidiaries.

[2] We hereafter refer only to petitioner, rather than jointly to petitioner and her late husband.

liquidation under Chapter 7. Those successive petitions prevented respondents from exercising their rights under the deed of trust and completing the non-judicial sale.

2. In the Chapter 7 proceeding, petitioner filed a complaint asking the bankruptcy court to divest respondents of their right to proceed against the property. In particular, petitioner sought a declaration, first, that respondents' lien was valid only to the extent of the judicially determined value of the farm parcels and, second, that petitioner had a right under the Bankruptcy Code to redeem the parcels for that amount.[3] Petitioner argued that she was entitled to that relief under Section 506 of the Code, 11 U.S.C. § 506, even though she had no such rights under Utah law.[4] Pet. App. 3a, 16a-17a.

In June 1988, the bankruptcy trustee determined that the parcels were worth less than the lien, which, with interest on the outstanding debt, was then valued at roughly $120,000. The trustee therefore abandoned the property under 11 U.S.C. § 554, because the estate would not receive any net benefit from its liquidation. The same month, the bankruptcy court, after trial, reached a similar conclusion in determining that the parcels had a value of only $39,000. Pet. App. 16a.

[3] Petitioner's complaint did not mention a claimed right of redemption. As the opinions of the bankruptcy court and the court of appeals make clear, however, throughout this litigation petitioner has treated her lien-reduction claim as encompassing her claim for redemption of the property. *See* II R.O.A. 17-18 (trial brief of petitioner). Indeed, whereas she now argues that lien reduction is not the equivalent of redemption (Pet. 12) and purports to pursue only her lien-reduction claim in this Court, in the court of appeals she treated the issues as inseparable, asserting that she sought the right to "avoid liens and effectively redeem real property." Br. of Appellant 5; *see also id.* at 4, 7.

[4] Nothing in Utah law allowed reduction of the lien. Utah law would have allowed petitioner to redeem the parcels within three months of the notice of default. Utah Code Ann. § 57-1-24. Petitioner failed to exercise that right.

The bankruptcy court held, however, that Section 506 of the Code did not apply to the abandoned land, so that petitioner could not, by her action for lien reduction and redemption, deprive respondents of the amount (up to the outstanding debt) the land would bring at a sale, including amounts above the judicially determined $39,000. The court reasoned that, because the property had been abandoned by the bankruptcy trustee in this liquidation case and therefore no longer played a role in the administration of the estate, the property was no longer "property in which the estate has an interest" under Section 506. Any other interpretation, the court explained, would give petitioner more than she would receive outside bankruptcy: petitioner's view would strip respondents of their right to force a non-judicial sale (subject to any state-law redemption rights) and either buy the property themselves or collect the sale price (less certain expenses) up to the value of the outstanding secured debt. Pet. App. 30a. That result would simply give petitioner a windfall for no purpose related to the function of Section 506, which is "to facilitate the administration and distribution of the bankruptcy estate" by valuing and assigning priority to claims to be paid out from the accumulated estate, a process that was not to include this property. Pet. App. 29a; *id.* at 28a. For those and other reasons, the bankruptcy court dismissed petitioner's claim for relief under Section 506, leaving respondents with their state-law rights to proceed against the property. Pet. App. 14a-15a.

The district court affirmed the bankruptcy court's dismissal of petitioner's complaint (Pet. App. 12a-13a), and the court of appeals in turn affirmed (*id.* at 1a-11a). The Tenth Circuit, while relying heavily on the bankruptcy court's reasoning, also explained that petitioner's view of Section 506 would be inconsistent with Section 722 of the Code. Pet. App. 9a-10a. Congress expressly provided debtors a federal right to redeem abandoned property in Section 722, but that provision is expressly

limited to certain kinds of personal property, thus excluding land. Yet allowing lien reduction under Section 506, the court of appeals reasoned, would effectively give the debtor the right to redeem land for the reduced amount (transaction costs aside, a debtor with the money to redeem property could presumably outbid any other bidder at a sale, because the excess price over the reduced lien value would simply be paid back to the debtor). Pet. App. 10a.

The court of appeals acknowledged that the Third Circuit had recently held that Section 506 does apply in a liquidation case to property, such as abandoned property, that is not to be administered in the bankruptcy proceeding. Pet. App. 3a, discussing *Gaglia v. First Federal Sav. & Loan Ass'n*, 889 F.2d 1304 (1989). Explaining its disagreement with *Gaglia*, the court below pointed out that the Third Circuit had failed to recognize that, while Section 506 is not in terms a redemption provision, allowing its use in circumstances like those here would effectively make it one, in conflict with Section 722's restriction of redemption rights to personal property. Pet. App. 10a. The Tenth Circuit also explained that, at bottom, the Third Circuit had relied on the erroneous view that use of Section 506 to strip down the lien reproduced the result that would occur outside bankruptcy (a benchmark that the Tenth and Third Circuits agreed was proper). In fact, the Tenth Circuit explained, a reversion of the property to pre-bankruptcy status—which is what occurs upon abandonment (Pet. App. 5a)—would not limit the lienholders' recovery to the judicially determined price; it would give the lienholders the right to purchase the property themselves or to sell it to the highest bidder (subject to any state-law redemption rights), with the lienholders collecting the sale price (less expenses) up to the amount they are still owed. Pet. App. 7a-8a, 10a-11a. The Third Circuit's reading of Section 506 produces a different result, even though the property plays no role in the bankruptcy.

REASONS FOR DENYING THE WRIT

We recognize that the decision below conflicts with the decision of the Third Circuit in *Gaglia*. It is also clear that the bankruptcy courts are divided on the issue of Section 506's application in a Chapter 7 case to real property that is not to be liquidated, distributed, or otherwise administered in the bankruptcy proceeding. Pet. 8-9. For several reasons, however, we think that review of the issue at this time and in this case is not warranted.

Only two courts of appeals have addressed the question. As the Tenth Circuit (Pet. App. 3a) and Third Circuit (*Gaglia*, 889 F.2d at 1306-07) have both noted, the Seventh and Eleventh Circuits have spoken on related issues, but neither has been presented with the question whether Section 506 applies to abandoned real property in a Chapter 7 case. In *In re Lindsey*, 823 F.2d 189 (7th Cir. 1987), the undersecured lienholder did not challenge the award of a redemption right to the debtor (presumably either because the redemption value was sufficiently close to the amount the lienholder believed it would receive at foreclosure or because the lienholder did not believe that the debtor could acquire the money to exercise the redemption right). In *In re Folendore*, 862 F.2d 1537 (11th Cir. 1989), the court did not address the issue of abandoned property, but the distinct issue of whether Section 506(d), in its pre-1984 version, applies to a lienholder's claim if the bankruptcy court has not disallowed the claim.[5]

In light of the freshness of the conflict at the appellate-court level, we think that it would be advisable to await further developments. For one thing, now that the conflict exists among two courts of appeals, Congress may

[5] It is this latter issue that is expressly mentioned by the single paragraph of *Collier on Bankruptcy* cited by petitioner. Pet. 9 (citing 3 *Collier on Bankruptcy* ¶ 506.07, at 506-75 (15th ed. 1990)). That paragraph does not separately discuss the question of Section 506's application in a liquidation case to abandoned real property.

well step in to clarify the matter. Congress has substantively amended the Bankruptcy Code numerous times since 1978, including Section 506 itself.[6] In enacting those revisions, Congress has shown itself to be closely attentive to problems that arise in the judicial application of the Code.[7] If the present issue is truly a significant one, it can be expected that Congress will take notice and address the matter. Indeed, if the issue is of importance, it is likely to be brought to the attention of Congress by the representatives of major institutional lenders, such as mortgage banks or the lending agencies of the United States (*e.g.*, the Small Business Administration, which was the lienholder in *Gaglia*, or the Farmers' Home Administration, the lienholder in *Lindsey*).[8] There has not yet been an opportunity for that process to work.

There is also new reason for the Third Circuit to reconsider its decision in *Gaglia*. Following suggestions in *Folendore* and *Lindsey*, the *Gaglia* court relied on a

[6] Bankruptcy Judge Lavien noted in 1990 that there has been "almost a yearly significant Congressional input on bankruptcy." Bankruptcy Highlights, in *Bankruptcy Code, Rules and Forms* at vii (West 1990 ed.). *See, e.g.*, Municipal Bankruptcy Amendments, Pub. L. No. 100-597, 102 Stat. 3028 (1988); Intellectual Property Licenses in Bankruptcy, Pub. L. No. 100-506, 102 Stat. 2538 (1988); Retiree Benefits Bankruptcy Protection Act of 1988, Pub. L. No. 100-334, 102 Stat. 610 (1988); Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986); Omnibus Budget Reconciliation Act of 1986, Pub. L. No. 99-509, § 5001, 100 Stat. 1911 (1986); Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, Title III, 98 Stat. 352-92 (1984); Bankruptcy Act Amendments, Pub. L. No. 97-222, 96 Stat. 235 (1982).

[7] *See, e.g.*, S. Rep. No. 505, 100th Cong., 2d Sess. (1988); S. Rep. No. 119, 100th Cong., 1st Sess. (1987); H.R. Conf. Rep. No. 958, 99th Cong., 2d Sess. 47, 49 (1986); H.R. Rep. No. 420, 97th Cong., 2d Sess. (1982).

[8] The United States has been involved in many of the cases cited by petitioner (Pet. 8-9), urging that Section 506 does not apply to abandoned real property in Chapter 7 cases.

broad view of the "fresh start" policy of bankruptcy as a reason for holding Section 506 applicable to real property that is not to be administered in the bankruptcy proceeding. 889 F.2d at 1308-09. This Court, however, recently rejected a similar judicial misreliance on an excessively expansive view of the fresh start policy, explaining that the policy does not have independent force that displaces the ordinary means of statutory construction. *Grogan v. Garner*, No. 89-1149 (Jan. 15, 1991), slip op. 7 (reversing decision relying on policy in construing the discharge-exception provision, Section 523, of the Code).

In so doing, moreover, the Court in *Grogan* clarified the limited scope of the fresh start policy: it serves simply to prevent encumbrance of a discharged bankrupt with pre-existing personal debts. Slip op. 7. Yet that policy—in contrast to the broad pro-debtor policy relied on by the *Gaglia* opinion—has no application at all in the present context. Even if the lien retains its full value, the lien runs only against the property, not against the debtor: regardless of the lien, the bankruptcy discharge frees the debtor from the personal debt secured by the lien. The only question is whether the debtor is entitled to be handed a sum of money that represents (non-equity) value of the property realized at a sale. Petitioner's claim for that windfall benefit is a claim not for a "*fresh* start," but for a "*head* start."[9] The Third Circuit should be given the opportunity to reconsider its view in light of *Grogan* (and of the decision in the present case).

In the meantime, there is no pressing need to address the issue presented here. In any given case, what is at stake is the difference between the judicially determined value and the market value of the property (generally, what it would bring at a sale). That difference will be large only if the court's determination is substantially

[9] *Lines v. Frederick*, 400 U.S. 18, 21 (1970) (Harlan, J., dissenting).

inaccurate or if the property has appreciated substantially since the filing of the bankruptcy petition (if that date is used for valuing the property).[10] That the difference is not often large is suggested by the failure of either party to take an appeal in virtually all of the cited bankruptcy-court decisions (Pet. 8-9), including, notably, the failure of the United States to appeal the grant of a redemption right in *Lindsey*. If the stakes are significant in an appreciable number of cases, it is highly likely that a major institutional lender such as the government will bring the matter to this Court (if the conflict persists).[11]

Finally, the Tenth Circuit adopted the proper reading of Section 506, so there is no need for correction of this particular ruling. The bankruptcy court and the Tenth Circuit opinions persuasively demonstrate that the statute is best interpreted not to strip a lienholder of non-bankruptcy property rights—not to give a debtor more than she would be entitled to outside bankruptcy—when the property at issue is not to play any role in the administration of the bankruptcy estate because it has been abandoned in a liquidation case. In these circumstances,

[10] Some of the decisions relied on by petitioner (Pet. 8) indicate that the property is to be valued as of the date of the filing of the bankruptcy petition. *See, e.g., In re Donohue*, 110 B.R. 41, 44 (Bankr. D. Kan. 1990); *In re Lindsey*, 64 B.R. 19, 24 (Bankr. C.D. Ill. 1986); *but cf.* 3 *Collier on Bankruptcy* ¶ 506.04, at 506-37- to -38 (15th ed. 1990). Otherwise, even if petitioner were entitled to lien reduction under Section 506, respondents would be entitled to a new valuation of the property on remand to reflect any appreciation in the value of the property. Petitioner has not suggested that she would accept such a new valuation.

[11] In the present case, the stakes appear to involve between $0 and approximately $15,000. That estimate is based on the difference between the amount of purchase offers that have been received and the amount respondents would receive upon lien reduction, with the latter amount varying according to differing views about how much interest respondents are entitled to add to the figure of $39,000 determined in June 1988.

there is no sound justification for reading Section 506 to disturb the non-bankruptcy property entitlements of the lienholder and to give the debtor the windfall of (non-equity) value of the land. The statutory language was therefore properly given its natural meaning by the court of appeals: the abandoned property, which will play no role in the bankruptcy proceeding, is not "property in which the estate has an interest." 11 U.S.C. § 506(a).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

RICHARD G. TARANTO
(Counsel of Record)
ONEK, KLEIN & FARR
2550 M Street, N.W.
Suite 350
Washington, D.C. 20037
(202) 775-0184

MICHAEL Z. HAYES
MAZURAN, VERHAAREN & HAYES
2180 South 1300 East
Suite 260
Salt Lake City, UT 84106

Dated: January 23, 1991

(3)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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REPLY BRIEF FOR PETITIONER

TIMOTHY B. DYK
(Counsel of Record)
PATRICIA A. DUNN
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939
Counsel for Petitioner

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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REPLY BRIEF FOR PETITIONER

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1. Respondents concede that the Third Circuit and Tenth Circuit are in conflict concerning the proper interpretation of Section 506(d) of the Bankruptcy Code and "that the bankruptcy courts are divided on the issue." Opp. at 6. They likewise recognize that the Seventh and Eleventh Circuits have indicated, while "[speaking] on

related issues," that Section 506(d) allows Chapter 7 debtors to void the undersecured portion of liens on real property. Opp. at 6. Since the filing of the Petition, moreover, still other federal courts have divided on the issue, demonstrating its continuing importance. *See In re Lange*, 120 B.R. 132 (Bankr. 9th Cir. 1990) (following Tenth Circuit below in holding that Chapter 7 debtor cannot use Section 506(d) to void undersecured portion of real property lien); *In re Douthart*, 1990 Bankr. LEXIS 2740 (Bankr. D.N.H. 1990) (same); *In re Richardson*, 1990 Bankr. LEXIS 2467 (Bankr. S.D. Ill. 1990) (following Seventh Circuit in holding that Chapter 7 debtor can use Section 506(d) to void undersecured portion of real property lien).

2. Respondents nonetheless suggest that the "freshness" (Opp. at 6) of this ever-widening conflict counsels against review in this case. But none of Respondents' reasons for ignoring this conflict and delaying resolution of this important and recurrent issue is persuasive.

First, Respondents argue that "there is no pressing need to address the issue presented here" because the value of these cases "is not often large" and because a "major institutional lender" might, at some later date, seek certiorari in a case where the "stakes are significant." Opp. at 8-9. That the application of Section 506(d) in many individual cases may not involve significant amounts, however, hardly suggests that the issue is unimportant to the individuals involved or, indeed, even to the lenders themselves. Recent press reports confirm that the matter is of substantial importance; it is an issue that is worth "millions of dollars" to the lending industry and "appears destined to spread throughout the country . . . as the recession worsens." Lehman, *Mortgage 'Cramdowns' Ease Debt Burden*, Wash. Post, Jan. 5, 1991, at F1, col. 4 (describing interests of Mortgage Bankers Association and Freddie Mac in pursuing a "test case" on this issue).

The reluctance of many parties to litigate this issue through the courts of appeals to this Court, simply because their particular cases may not justify the costs of appeal, does not call for delaying resolution of the issue where, as here, it is brought to this Court's attention. If anything, this reluctance suggests the vital importance of prompt resolution so that the current uncertainty does not further burden the courts, debtors and creditors. Indeed, as the Solicitor General aptly noted in another individual bankruptcy case in which the Court granted certiorari last week, "[b]ecause non-business debtors typically lack the means (and their creditors the financial motivation) to litigate before this Court, this case presents an appropriate and unusual opportunity to achieve uniformity on this important issue throughout the circuits." Brief for the Respondent, *Toibb v. Radloff*, No. 90-368 (Jan. 2, 1991), at 4.

Second, Respondents suggest that the conflict could evaporate if the Third Circuit has an opportunity, in some unidentified case, to "reconsider its view in the light of" this Court's recent decision in *Grogan v. Garner*, No. 89-1149, slip op. (Jan. 15, 1991). Opp. at 7-8. But the *Grogan* decision offers no "new reason" (Opp. at 7) for the Third Circuit to do so. In *Grogan*, this Court simply held that the dischargeability exceptions in Section 523(a) of the Bankruptcy Code, including the fraud exception, are subject to proof under the ordinary preponderance of the evidence standard. *Grogan*, slip op. at 11. While the Court concluded that the Code's "fresh start" policy does not require a higher standard of proof in fraud cases, it in no way undermined the significance of that policy in construing other sections of the Bankruptcy Code. *Id.* at 7. In any event, the Third Circuit did not rest its decision in *In re Gaglia*, 889 F.2d 1304 (3d Cir. 1989), primarily on this "fresh start" policy; rather, it grounded its holding in the "plain meaning" of Section 506(d). *Id.* at 1308.

Third, Respondents contend that the Court should deny certiorari because "Congress may well step in to clarify the matter." Opp. at 6-7. This possibility, of course, exists in every case where this Court is presented with an issue of statutory construction. It hardly provides a reason for denying certiorari—particularly where, as here, Respondents have identified no pending legislation that addresses this issue, much less any legislation that Congress is likely to enact into law.

3. This case squarely presents the question whether Section 506(d) enables a Chapter 7 debtor to void the undersecured portion of a lien on abandoned real property. That issue is of continuing importance, affecting many hundreds of American farmers and other individuals as well as the lenders with whom they do business. No sound reason exists for delaying this Court's consideration of the issue.

CONCLUSION

The Petition should be granted.

Respectfully submitted,

TIMOTHY B. DYK
(Counsel of Record)
PATRICIA A. DUNN
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939
Counsel for Petitioner

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Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF FOR THE PETITIONER

TIMOTHY B. DYK
(Counsel of Record)
PATRICIA A. DUNN
PATRICK J. POTTER
DEENA B. JENAB
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939
Counsel for Petitioner

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether Section 506(d) of the Bankruptcy Code enables a Chapter 7 debtor to void a lien on real property abandoned by the bankruptcy trustee to the extent that the lien exceeds the property's value.

PARTIES TO THE PROCEEDING

The parties to the proceedings in the court below were: LaMar and Aletha Dewsnup and Louis L. Timm, John Neiuwland and Floyd M. Childs, Trustees of the United Precision Machine and Engineering Company Profit-Sharing Trust; ABCO Insurance Agency, Inc.; and Joseph L. Henroid, as Trustee for the Annette Jacob Trust.

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4 L. King, *Collier on Bankruptcy* ¶ 554.02 (15th ed. 1990) 28

4 L. King, *Collier on Bankruptcy*, ¶ 722.05 (15th ed. 1990) 16, 27

5 L. King, *Collier on Bankruptcy*, ¶ 1111.02 (15th ed. 1990) 23

5 L. King, *Collier on Bankruptcy*, ¶ 1322.06 (15th ed. 1990) 19

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-741

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit (Pet. App. 1a-11a) is reported at 908 F.2d 588. The order of the United States District Court for the District of Utah (Pet. App. 12a-13a), affirming the judgment of the bankruptcy court, is unreported. The memorandum opinion of the United States Bankruptcy Court for the District of Utah (Pet. App. 16a-32a) is reported at 87 Bankr. 676; its order of dismissal (Pet. App. 14a-15a) is unreported.

JURISDICTION

The court of appeals entered its judgment on July 11, 1990. On September 20, 1990, this Court granted Petitioner's request for an extension of time to file her Petition for a Writ of Certiorari until November 8, 1990. The Petition was timely filed on November 8, 1990. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) (1988).

STATUTORY PROVISIONS INVOLVED

Section 506 of the Bankruptcy Code, 11 U.S.C. § 506 (1988), provides:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.
>
> (b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.
>
> (c) The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—
>
> (i) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
>
> (ii) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

Section 541 of the Bankruptcy Code, 11 U.S.C. § 541 (1988), provides in pertinent part:

> (a) The commencement of a case under section 301, 302 or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case. . . .

Section 554 of the Bankruptcy Code, 11 U.S.C. § 554 (1988), provides in pertinent part:

> (a) After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.

Section 722 of the Bankruptcy Code, 11 U.S.C. § 722 (1988), provides in pertinent part:

> An individual debtor may . . . redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under Section 522 of this title or has been abandoned under Section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

Section 1111 of the Bankruptcy Code, 11 U.S.C. § 1111 (1988), provides in pertinent part:

> (b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless . . . .
>
> (2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

Section 1322 of the Bankruptcy Code, 11 U.S.C. § 1322 (1988), provides in pertinent part:

> (b) Subject to subsections (a) and (c) of this section, the plan may— . . . .
>
> (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; . . . .

STATEMENT

This case presents the question whether, under Section 506(d) of the Bankruptcy Code, a Chapter 7 debtor can void a lien on abandoned real property to the extent that the lien exceeds the property's value.

In July 1984, Petitioner Aletha Dewsnup and her now-deceased husband, LaMar Dewsnup, sought the protections of Chapter 7 of the Bankruptcy Code in order to discharge their debts and secure a fresh start. Joint Appendix ("J.A.") at 2. Prior to 1978, the Dewsnups had owned outright two parcels of unencumbered farmland in Deseret and Oak City, Utah. *See* J.A. 5. On June 1, 1978, the Dewsnups borrowed $119,000 from the respondents to enable them to purchase another tract of land—the so-called "Arrow Property"—near the Deseret

and Oak City properties. *Id.* at 14, 27-36. To secure this loan, the Dewsnups gave the respondents a first mortgage on both the Deseret and Oak City properties (*id.*) and effectively a second mortgage on the Arrow Property (*id.* at 15, 37-38).[1]

In 1980, after selling certain assets, the Dewsnups paid over $150,000 to the respondents, representing the principal and interest on the $119,000 loan. J.A. 13, 15. The respondents, however, refused to discharge the loan (*id.* at 13), claiming that the Dewsnups had fallen behind on their mortgage payments and property taxes on the Arrow Property and that respondents had paid $49,966.21 to bring current the Dewsnups' first mortgage and taxes on the Arrow Property, thereby protecting their second mortgage. *Id.* at 15. The respondents then sought to foreclose on the Deseret and Oak City properties. *Id.* In April 1981, the respondents obtained a $49,966.21 judgment lien against the Dewsnups representing the amount that they had paid purportedly to protect their second mortgage. *Id.*

In June 1984, after two unsuccessful attempts at reorganization under Chapter 11 of the Bankruptcy Code, the Dewsnups commenced proceedings to liquidate their assets under Chapter 7. J.A. 2, 15-16. Under the Bankruptcy Code's automatic stay provision, the Dewsnups' filing stayed the respondents' attempted foreclosure sale of the Deseret and Oak City properties. *See* 11 U.S.C. § 362 (1988).

In early 1987, the Dewsnups filed an adversary proceeding to void a portion of the respondents' lien under Section 506 of the Bankruptcy Code. J.A. 3-9. They

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[1] The mechanism of this arrangement was somewhat unusual. Since the Dewsnups did not own the Arrow property, which was apparently already encumbered by a first mortgage, the Dewsnups assigned their purchase contract on the Arrow property as additional security for the loan. *See* J.A. 37-38.

did so because the claimed amount of the respondents' lien—an amount asserted to be roughly $120,000 because of the addition of interest and attorneys' fees (*see* Opp. Cert. at 3)—exceeded the fair market value of the Oak City and Deseret properties. *Id.* at 5.

The Dewsnups thus requested the bankruptcy court (1) to determine the extent of the respondents' secured claim on the property under Section 506(a) of the Code, which provides that an allowed claim of a creditor "is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim" (11 U.S.C. § 506(a)); (2) to void the lien to the extent that the respondents' claim exceeded the value of the property under Section 506(d), which provides that, "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void" (11 U.S.C. § 506(d)); and (3) to allow them to redeem the property by paying the respondents its fair market value. J.A. at 4-6.

At the June 15, 1987 trial, the bankruptcy court valued the property at $39,000—substantially less than the claimed value of the respondents' lien—but declined to allow the Dewsnups to void the lien to the extent that it exceeded the property's value. Pet. App. 2a, 16a. The bankruptcy court first assumed that the trustee had abandoned, or would abandon, the Dewsnups' property under Section 554 of the Bankruptcy Code. *Id.* at 17a n.1. It then held that Section 506(d) did not allow the Dewsnups to void the respondents' lien because that section applies only to "property in which the estate has an interest" (*id.* at 23a, citing 11 U.S.C. § 506(a)); in the court's view, property that the estate has abandoned under Section 554 of the Bankruptcy Code "is no longer property of the estate and the estate, consequently, has no interest in the property." *Id.* at 24a.

The bankruptcy court asserted that Congress designed Section 506 only to facilitate the distribution of the bankruptcy estate through the bifurcation of secured and unsecured claims on "property in which the estate has an interest." Pet. App. 28a, citing 11 U.S.C. § 506(a). The court found it "inconceivable . . . that Congress could have intended to create an avoiding power in a Chapter 7 debtor, respecting property which is not to be administered through the bankruptcy process, and which is based on a dichotomy created to facilitate the administration and distribution of the bankruptcy estate." *Id.* at 29a. The court then concluded that, as a policy matter, Chapter 7 debtors should not be able to retain their title to property at the expense of the creditors' rights to protect themselves at a forced sale. *Id.* at 30a. This conclusion, according to the court, would not "impede the debtors' fresh start" because they could simply "give up their interest in the property and obtain their fresh start." *Id.*

On July 11, 1988, in light of the court's conclusion that the lien exceeded the property's value, the Chapter 7 trustee abandoned the Deseret and Oak City properties pursuant to Section 554 of the Bankruptcy Code. J.A. 24. The trustee concluded that this property was burdensome to the bankruptcy estate in that the value of the property was less than the respondents' lien and unsecured creditors would, accordingly, realize nothing in a sale of the property. J.A. 24; *see* Pet. App. 3a n.2, 5a. The effect of the abandonment was to revest title to the Deseret and Oak City properties in the Dewsnups.

The district court summarily affirmed the bankruptcy court's decision (Pet. App. 12a-13a) and, on appeal, the Tenth Circuit affirmed in turn (*id.* at 1a-11a). The Tenth Circuit began by noting that:

> Courts denying relief [to Chapter 7 debtors] under [Section 506(d)] have stated various reasons for doing so, including: 1) that abandoned property

> is not administered by the estate and therefore sections 506(a) and (d) have no application; 2) that allowing this relief inequitably gives debtors more in a Chapter 7 liquidation than they would receive in the reorganization chapters; and finally, 3) that allowing avoidance pursuant to section 506(d) renders the redemption provision found in Code section 722 meaningless.

Pet. App. 4a.

In various parts of its opinion, the court of appeals then appeared to accept each of these theories:

First, the court of appeals concluded that Section 506(d) was unavailable to Chapter 7 debtors because it would allow debtors to receive "more in liquidation than they would receive in a reorganization." Pet. App. 9a. According to the court, its interpretation of Section 506 was "bolstered . . . through review of the creditors rights provisions found in Chapters 12 and 13." *Id.* at 8a. The court noted that these chapters provide creditors with protections against modification or impairment of certain secured claims on real property (*id.* at 8a-9a, citing 11 U.S.C. § 1322(B)(2) and 11 U.S.C. § 1111(b)(2)); it thus concluded that permitting debtors to use Section 506(d) to retain abandoned property would undercut Congress's "strong preference for reorganization rather than liquidation." *Id.* at 9a.

Second, the court of appeals concluded that Section 506(d) did not apply to real property. It found that Section 722, the Code's redemption provision, was "instructive." Pet. App. 9a. Because Section 722 allows redemption of personal property but not real property, the court found it "'obvious that Congress did not intend to permit a debtor to redeem his real property through the use of § 506(d).'" *Id.* at 9a-10a (citation omitted).

Finally, the court agreed with the bankruptcy court that Section 506(a) does not apply to abandoned property

(Pet. App. 5a-7a), explaining that Section 506(a) applies only to "property in which the estate has an interest" (*id.* at 6a); that "[t]he estate has no interest in, and does not administer, abandoned property" (*id.*); and that the Dewsnups thus could not use Section 506 to void the respondents' lien on their property because "the estate no longer ha[d] an interest" in the property following its abandonment "even though it did at one time." *Id.* at 7a-8a.[2] The court thus held that "[t]he plain language of the statute, coupled with the abandonment provision of the code, indicate[s that] Congress did not intend to allow Chapter 7 debtors to use Section 506(d) to retain abandoned property." *Id.* at 8a.

SUMMARY OF ARGUMENT

The court of appeals misinterpreted the Bankruptcy Code when it held that Chapter 7 debtors cannot void liens on abandoned real property under Section 506(d). This Court has already construed Section 506 of the Bankruptcy Code in accordance with its plain terms; in *United States v. Ron Pair Enterprises*, 489 U.S. 235, 238-39 (1989), it explained that Section 506 "governs the definition and treatment of secured claims, *i.e.*, claims by creditors against the estate that are secured by a lien on property in which the estate has an interest," and that "a claim is secured only to the extent of the value of the property on which the lien is fixed." Section 506(d)'s words are equally clear: "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void. . . ." 11 U.S.C. § 506(d). These plain words mean that a debtor can void a lien on real property to the extent that it exceeds the property's value.

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[2] The court of appeals nonetheless appeared to recognize that the estate retains an "interest" in abandoned property under Chapters 11, 12, and 13 of the Code. Pet. App. 8a.

None of the court of appeals' arguments for evading Section 506(d)'s plain words and effect in Chapter 7 proceedings has merit. First, the court's suggestion, based on policy arguments, that Section 506(d) does not apply in Chapter 7 liquidations, but rather only in the reorganization chapters of the Code, is contrary to the Code's words and structure. Nothing in Section 506(d) makes its lien avoidance rule inapplicable to Chapter 7 proceedings. Indeed, Section 103(a) of the Code makes abundantly clear that the provisions of Chapter 5—of which Section 506(d) is a part—apply fully to Chapter 7 cases.

The court of appeals' conclusion that this statutorily-compelled result is somehow inappropriate rests on its view that the creditors' rights provisions in Chapters 11 and 13 provide protections against the modification of certain liens and that, as a matter of policy, making lien avoidance under Section 506(d) available to Chapter 7 debtors would encourage liquidations rather than reorganizations. The court's argument that lien avoidance is inconsistent with Section 1322(b)(2) of the Code misperceives the role of Section 506 in that context; it is clear that Section 506(a) and (d) apply to liens protected from modification under Section 1322(b)(2) in the same manner that they apply to liens on property in Chapter 7 cases. The court's argument that lien avoidance is inconsistent with Section 1111(b) of the Code, which permits creditors to elect to treat their unsecured claims as though they were secured, fares no better; it ignores completely that this Section 1111(b) election is, by its terms, an express exception to Section 506.

Second, the court of appeals' argument, based on Section 722 of the Code, that Section 506(d) does not allow Chapter 7 debtors to void liens on real property likewise provides no basis for avoiding the clear words of Section 506(d). To be sure, Section 722 is the only "redemption" provision in Chapter 7 and applies only to personal property. But this does not mean that Section 506(d) cannot void liens on real property. Section 722 exists in the Code for a specific purpose unrelated to real property: to address Congress's perceived need to prevent abuses peculiar to consumer credit arrangements by enacting a redemption mechanism for personal property that gives debtors broader rights under the Code than were available under non-bankruptcy law. This specific provision does not demonstrate that Congress intended to deprive Chapter 7 debtors of the right to void liens on real property under Section 506(d) and to redeem that property, if possible, under state law.

Third, the court of appeals' argument that Section 506(d) does not apply to abandoned real property, and thus that Chapter 7 debtors cannot use Section 506(d) to void liens on abandoned real property, is unfounded. It ignores that Congress deliberately chose not to use the term "property of the estate" in Section 506 and opted instead for the phrase "property in which the estate has an interest"—a word choice that reinforces the conclusion that the latter phrase connotes something broader than "property of the estate." It ignores that Section 722, which applies to abandoned property, depends on Section 506's valuation and bifurcation provisions—making it unequivocally clear that Section 506(a)'s reference to "property in which the estate has an interest" must encompass abandoned property that is no longer "property of the estate." And it ignores that construing "property in which the estate has an interest" to exclude overencumbered and abandoned property would deprive Section 506(d) of one of its central functions: to void liens on property where the value of the lien exceeds the value of the collateral.

ARGUMENT

This case presents a straightforward question of statutory interpretation: whether the Bankruptcy Code allows Chapter 7 debtors to void liens on abandoned real property to the extent that a creditor's claim exceeds the value of the property. While Section 506(d) of the Code provides, in emphatic terms, an affirmative answer to this question, the court below reached the opposite conclusion.

Though its analysis is far from lucid, the court of appeals appeared to substantiate its erroneous conclusion with three, equally flawed, arguments. *First*, the court of appeals suggested, on the basis of policy arguments, that Section 506(d) does not apply at all in Chapter 7 liquidations. *Second*, based on the existence of Section 722 of the Code, which contemplates the use of Section 506 to void liens on certain personal property, the court of appeals asserted that Section 506(d) cannot apply to real property in Chapter 7 liquidations. And, *third*, supposedly based on the plain language of Section 506, the court found that Section 506(d) does not apply to real property that the trustee has abandoned in Chapter 7 liquidations.

This Court recently had occasion to address Section 506 of the Bankruptcy Code in *United States v. Ron Pair Enterprises*, 489 U.S. 235 (1989), where it held that the plain language of Section 506(b) entitles creditors to post-petition interest on nonconsensual, oversecured allowed claims in a Chapter 11 case. Here, as in *Ron Pair*, "[t]he task of resolving the dispute over the meaning of § 506[] begins where all such inquiries must begin: with the language of the statute itself." *United States v. Ron Pair Enterprises*, 489 U.S. at 241. That inquiry, of course, requires examination not only of the particular words of Section 506, but of the broader design of the statute as well. *See K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988). This examination makes clear that the court of appeals erred in each of its three contradictory conclusions—and that the correct view is that articulated by the well-reasoned decision of the Third Circuit in *Gaglia v. First Federal Sav. & Loan Ass'n*, 889 F.2d 1304 (3d Cir. 1990), and the decisions of a majority of bankruptcy courts.[3] The court of appeals' holding amounts to nothing more than an effort to substitute the court's own views of appropriate bankruptcy policy for the specific provisions adopted by Congress in the 1978 Bankruptcy Code.

I. THE PLAIN LANGUAGE AND STRUCTURE OF THE BANKRUPTCY CODE MAKE CLEAR THAT SECTION 506(d) APPLIES IN CHAPTER 7 LIQUIDATIONS.

A. Section 506(d), By Its Terms, Allows Debtors To Void Liens In Chapter 7 Proceedings.

In *Ron Pair*, this Court explained that Section 506 of the Bankruptcy Code "governs the definition and treatment of secured claims." *United States v. Ron Pair Enterprises*, 489 U.S. at 238-39. The first subsection of Section 506 defines the provision's scope: it applies to any "allowed claim of a creditor secured by a lien on property in which the estate has an interest." 11 U.S.C.

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[3] *See In re Kostecky*, 111 Bankr. 823 (Bankr. D. Minn. 1990); *In re Donahue*, 110 Bankr. 41 (Bankr. D. Kan. 1990); *In re Moses*, 110 Bankr. 962 (Bankr. N.D. Okla. 1990); *In re Zobenica*, 109 Bankr. 814 (Bankr. W.D. Tenn. 1990); *In re Zlogar*, 101 Bankr. 1 (Bankr. N.D. Ill. 1989); *In re Hunter*, 101 Bankr. 294 (Bankr. S.D. Ala. 1989); *United States v. Garnett*, 99 Bankr. 757 (W.D. Ky. 1989), *aff'g*, 88 Bankr. 123 (Bankr. W.D. Ky. 1988); *In re Crouch*, 76 Bankr. 91 (Bankr. W.D. Va. 1987); *In re O'Leary*, 75 Bankr. 881 (Bankr. D. Ore. 1987); *In re Worrell*, 67 Bankr. 16 (C.D. Ill. 1986); *In re Cleveringa*, 52 Bankr. 56 (Bankr. N.D. Iowa 1985); *In re Lyons*, 46 Bankr. 604 (Bankr. N.D. Ill. 1985); *In re Gibbs*, 44 Bankr. 475 (Bankr. D. Minn. 1984); *In re Bracken*, 35 Bankr. 84 (Bankr. E.D. Pa. 1983); *Brace v. State Farm Mutual Automobile Ins. Co.*, 33 Bankr. 91 (Bankr. S.D. Ohio 1983); *In re Vigne*, 18 Bankr. 946 (Bankr. W.D. Pa. 1982); *In re Tanner*, 14 Bankr. 933 (Bankr. W.D. Pa. 1981); *In re Lindsey*, 64 Bankr. 19 (C.D. Ill. 1986).

§ 506(a).[4] Section 506(a) then provides for the definition and bifurcation of such claims. In plain terms, it provides that an allowed claim "is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim." *Id.* This means, in this Court's words, that "a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured." *United States v. Ron Pair Enterprises*, 489 U.S. at 239.

Section 506(d) follows naturally from this point of reference. Having provided for the bifurcation of claims into secured and unsecured components in Section 506(a), Congress described, in subsection (d), the effect of bifurcation on claims that are not "allowed secured claim[s]" because the property is overencumbered.[5] Section 506(d) provides that, "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void. . . ." 11 U.S.C. § 506(d). The statute broadly defines a "lien" as any "charge against or interest in property to secure payment of a debt or performance of an obligation" (11 U.S.C. § 101(37) (1988), *as amended by* Pub. L. No. 101-647 (November 25, 1990))—a definition that plainly encompasses mortgage liens on real property. *See* H.R. Rep. No. 595, 95th

[4] An allowed claim is defined in Section 502(a). That section provides that "[a] claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects." 11 U.S.C. § 502(a) (1988).

[5] The two subsections that separate Section 506(a) and (d) deal with claims secured by property where the value of the property exceeds the value of the claims. *See* 11 U.S.C. § 506(b), (c). Section 506(b) was the section primarily at issue in *Ron Pair*, 489 U.S. 235.

Cong., 1st Sess., at 312 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6269; S. Rep. No. 989 95th Cong., 2d Sess., at 25 (1978), *reprinted in* 1978 U.S. Code Cong. & Admin. News at 5811 ("liens" include security interests in property). The statute also broadly defines a "claim" as virtually any "right to payment. . . ." 11 U.S.C. § 101(5) (1988), *as amended by* Pub. L. No. 101-647 (November 25, 1990). Section 506(d)'s lien avoidance rule thus could hardly be clearer: a debtor can void a lien on real property to the extent that the claim is unsecured—that is, to the extent that the lien exceeds the value of the property itself.[6]

On the face of the statute, there is no indication that either Section 506 in general or Section 506(d) in particular is inapplicable to Chapter 7 proceedings. Under the Bankruptcy Code, debtors have the choice of filing under several different chapters: debtors can choose Chapter 7, which is broadly available to both individuals and entities, and liquidate their assets, distribute the proceeds to creditors, and obtain a discharge of pre-filing debts (*see* 11 U.S.C. §§ 704, 726, 727(a) (1988)); certain individuals with limited debt can choose reorganization under Chapter 13 and, in so doing, retain their assets, pay their debts out of future earnings pursuant to a reorganization plan and obtain a broad discharge (*see* 11 U.S.C. §§ 1322, 1327, 1328 (1988));[7] and debtors

[6] The exceptions to this voiding rule are limited, but explicitly stated in the Code. Under Section 506(d), as amended in 1984, a lien remains valid where (1) it secures a claim that is not allowed only because it involves a claim against a codebtor or unmatured alimony and child support (*see* 11 U.S.C. § 506(d)(1), citing 11 U.S.C. § 502(b)(5) and (e) (1988)), or (2) the claim is not an "allowed secured claim" only because an entity failed to file a proof of claim under Section 501 (*see* 11 U.S.C. § 506(d)(2)). Neither exception precludes the application of Section 506(d) in this case.

[7] *See generally* R. Jordan & W. Warren, *Bankruptcy* 671 (2d ed. 1989).

can opt to reorganize under Chapter 11, while retaining possession of their property and structuring a plan of reorganization (*see* 11 U.S.C. §§ 1107, 1129 (1988)).

It is abundantly clear that Section 506(d)'s lien avoidance rule applies with full force to Chapter 7 proceedings, just as it applies to proceedings under these other chapters of the Code. Indeed, Section 103(a) of the Code expressly states that "chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title." 11 U.S.C. § 103(a) (1988). Thus, the provisions of Chapter 5—including necessarily Section 506—apply to bankruptcy proceedings under Chapter 7.[8]

B. The Policies Underlying The Reorganization Provisions Of The Code Do Not Render Section 506(d) Inapplicable In Chapter 7 Liquidations.

To avoid the obvious conclusion that Section 506(d) applies in Chapter 7 liquidations—a conclusion that the plain language of the Code compels—the court of appeals resorted to supposed policies of the Bankruptcy Code that, in its view, made application of Section 506(d) in Chapter 7 bankruptcy cases inappropriate. The court first concluded that "the language used in sections 506(a) and (d) was intended to facilitate valuation and disposition of property in the reorganization chapters of the code." Pet. App. 8a. Then, to "bolster" its conclusion that Section 506 is available in reorganizations but not liquidations, the court asserted that certain creditors' rights provisions in Chapters 11 and 13, which protect against modification of certain liens, show that lien avoidance is unavailable under Chapter 7 because a debtor should not receive more favorable treatment in liquidation than in reorganization. *Id.* The court of appeals, however, was mistaken.

The court of appeals' attempt to limit Section 506's purpose to "valuation and disposition of property" in the reorganization chapters disregards the purpose that Section 506 serves in Chapter 7 liquidations. Section 506(d) is fully consistent with one of the central purposes of the Bankruptcy Code: to enable debtors "to get out from under the debilitating effects of too much debt . . . [and] obtain a fresh start." H.R. Rep. 595, at 125, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6086. As this Court said in *Grogan v. Garner*, 111 S. Ct. 654, 659 (1991), this fresh start policy allows debtors to "reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'"

Though the court of appeals refused to accept Section 506(d)'s "fresh start" purpose, that purpose is obvious from the words of Section 506(d). *See Gaglia v. First Federal Sav. & Loan Ass'n*, 889 F.2d 1304, 1309 (3d Cir. 1989) (applying Section 506(d) to void liens on real property "will further the Code's policy of providing the debtor with a fresh start"); *Matter of Folendore*, 862

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[8] That Section 506 applies in Chapter 7 liquidations is, moreover, obvious from Section 722 of the Code. Section 722 allows Chapter 7 debtors to redeem certain personal property, if a lien on the property exceeds the value of the property, by paying the lienholder a lump-sum amount representing the property's fair market value. 11 U.S.C. § 722. Because Section 722's redemption provision explicitly requires the Chapter 7 debtor to pay the undersecured lienholder "the amount of [its] allowed secured claim" (11 U.S.C. § 722), Section 722 mandates resort to Section 506. *See* 4 L. King, *Collier on Bankruptcy*, ¶ 722.05[1] at 722-7 ("Redemption under Section 722 is accomplished by the debtor paying the lienholder the amount of the allowed claim secured by the lien. Under section 506(a), the amount of the allowed second claim of an undersecured creditor is the value of the secured party's collateral.") For Section 722 to have any meaning at all, therefore, Section 506 has to apply to Chapter 7 proceedings. *See In re Bell*, 700 F.2d 1053, 1055 n.3 (6th Cir. 1983) (using Section 506 to determine the amount that a debtor must pay to redeem property under Section 722), *citing In re Hart*, 8 Bankr. 1020, 1022 n.2 (Bankr. N.D.N.Y. 1981); *see also* 3 L. King, *Collier on Bankruptcy*, ¶ 506.04 at 506-16 (15th ed. 1990).

F.2d 1537, 1540 (11th Cir. 1989) ("The whole point of bankruptcy is to provide a debtor with a fresh start. Section 506 allows the debtor the option to begin anew on its former property.") Through its lien avoidance rule, Section 506(d) relieves debtors of burdensome liens on their property that exceed the fair market value of the property. And it precludes creditors from allowing their unsecured claims to pass through the bankruptcy case unaffected and, after the debtor's discharge, asserting those claims against any post-petition appreciation in the property. *Matter of Folendore*, 862 F.2d at 1540.[9]

Applying Section 506(d) in Chapter 7 liquidations, consistent with these purposes, does not undermine any policy of the reorganization chapters. Contrary to the court of appeals' conclusion (Pet. App. 8a-9a), permitting Chapter 7 debtors to void liens on overencumbered property is entirely consistent with Section 1322(b)(2) of the Code. Chapter 13 allows debtors to retain their assets, pay their debts out of future earnings pursuant to a reorganization plan and obtain a broad discharge. *See* 11 U.S.C. §§ 1322, 1327, 1328. Under Section 1322(b)(2), however, a Chapter 13 debtor's plan of reorganization cannot "modify the rights of holders of secured claims . . . secured only by a security interest in real

[9] Other provisions of the Code confirm that Congress intended Section 506(d) to operate in this manner and to serve this fresh start policy. In Section 522(c)(2), for example, Congress expressly recognized the availability and effect of lien avoidance in the context of exempt property. That section describes the types of liens on exempt property that are permitted to pass through bankruptcy unaffected; it excepts liens on exempt property that have been avoided under Section 506(d). 11 U.S.C. § 522(c)(2)(A)(ii) (1988); *In re Kostecky*, 111 Bankr. 823, 826 (Bankr. D. Minn. 1990) ("11 U.S.C. § 522(c)(2)(A)(ii) *explicitly envisions* the application of § 506(d) lien avoidance to exempt property"); *In re Haugland*, 83 Bankr. 648, 651 (Bankr. D. Minn. 1988). It thus makes clear that, through lien avoidance under Section 506(d), debtors can ensure that their exempt property will not be liable for pre-petition debt and thus obtain a fresh start.

property that is the debtor's principal residence. . . ." 11 U.S.C. § 1322(b)(2). Though the thrust of the court of appeals' Section 1322 argument is far from clear (Pet. App. 8a-9a), the court apparently believed (1) that Section 1322(b)(2)'s prohibition against modifying a creditor's claim secured solely by home mortgage prevents lien bifurcation and lien avoidance under Section 506 and (2) that, accordingly, lien "strip downs" should be unavailable in Chapter 7 proceedings because they would improperly encourage liquidation rather than reorganization.

This argument, however, starts with a faulty premise that even the court of appeals has since disclaimed. Contrary to the court's assumption in this case, the Tenth Circuit itself has specifically held that resorting to Section 506 for bifurcation of claims secured solely by home mortgages is entirely permissible under Section 1322(b)(2). *In re Hart*, 923 F.2d 1410 (10th Cir. 1991). Indeed, in *Hart*, the court correctly concluded (1) that Section 506(a)'s provision for bifurcation of claims into secured and unsecured components applies fully to Chapter 13 proceedings; (2) that the bifurcation of an undersecured mortgage into secured and unsecured claims under Section 506 does not constitute a prohibited "modification" of a secured claim under Section 1322(b)(2); and (3) that, as a result, only the secured portion of such a claim warrants protection under Section 1322(b)(2). *In re Hart*, 923 F.2d at 1415.

As the leading bankruptcy treatise notes, the effect of Section 506 in this context is that, despite Section 1322(b)(2), "an undersecured claim secured only by a security interest in the debtor's principal residence may still be divided into an allowed secured claim and an allowed unsecured claim, with the lien declared void to the extent it secures a claim in excess of the allowed secured claim." 5 L. King, *Collier on Bankruptcy*, ¶ 1322.06 at 1322-15 (15th ed. 1990). This conclusion

—which is fully consistent with the conclusions of every federal court of appeals to address the issue[10]—amply demonstrates that Section 506 operates in Chapter 13 in precisely the same manner that it operates in Chapter 7.[11]

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[10] *See Wilson v. Commonwealth Mortg. Corp.*, 895 F.2d 123 (3d Cir. 1990); *In re Hougland*, 886 F.2d 1182 (9th Cir. 1989). It is also consistent with the decisions of the majority of bankruptcy courts. *See In re McNair*, 115 Bankr. 520, 523 (Bankr. E.D. Va. 1990); *In re Demoff*, 109 Bankr. 902, 915 (Bankr. N.D. Ind. 1989); *In re Hill*, 96 Bankr. 809, 813-14 (Bankr. S.D. Ohio 1989); *In re Frost*, 96 Bankr. 804, 807 (Bankr. S.D. Ohio 1989).

[11] *See* Howard, *Stripping Down Liens: Section 506(d) and the Theory of Bankruptcy* (hereinafter "*Stripping Down Liens*") at 70-71 (Manuscript, to be published in 65 Am. Bankr. L.J. (1991)) (The manuscript has been lodged with the Court for the Court's convenience.) Even if Section 506 did not operate in Chapter 13 in this way, the court of appeals' conclusion that allowing Chapter 7 debtors to void liens under Section 506 would somehow improperly discourage Chapter 13 reorganization simply does not follow. The Bankruptcy Code contains provisions that make each chapter more or less appealing to a particular debtor. *See Gaglia v. First Federal Sav. & Loan Ass'n*, 889 F.2d at 1311; *In re Gibbs*, 44 Bankr. 475, 479 (Bankr. D. Minn. 1984) ("Obviously there are various provisions in all chapters of Title 11 which make them attractive for different reasons."). While Congress has expressed a preference for reorganization, the ultimate decision to choose reorganization over liquidation remains with the debtor (*see In re Silva*, 82 Bankr. 845, 846-47 (Bankr. S.D. Ohio 1987); *In re Ross*, 95 Bankr. 509, 510 (Bankr. S.D. Ohio 1988)). The debtor must consider the various incentives pointing to reorganization—including the prospect of retaining his property, the reduced stigma in reorganization, and the broader discharge. *See* Note, *The Debtor's Right To Restrict Lienholder Recovery to the Value of the Encumbered Property Under Section 506 of the Bankruptcy Code*, 11 J. Corp. L. 433, 447 (1986); *see also Stripping Down Liens*, at 75-79. The assumed availability of Section 506's strip-down provision in Chapter 7 but not in Chapter 13 might provide one incentive to the debtor to choose liquidation, but there is simply no basis for concluding that Congress intended to eliminate all attractive elements of Chapter 7 in order to force resort to the reorganization chapters.

The court of appeals' suggestion (Pet. App. 9a) that allowing Chapter 7 debtors to void liens under Section 506(d) is irreconcilable with reorganization under Chapter 11 is similarly flawed. It is true, of course, that Section 1111(b) prevents a Chapter 11 debtor from stripping down undersecured liens if a creditor has "elected" to have his claim treated as though it were fully secured. 11 U.S.C. § 1111(b). But the court of appeals' argument completely ignores that the Section 1111(b) election is, by its plain terms, an exception to Section 506. While "[t]he election in Section 1111(b) is an extraordinarily difficult provision in the Code" (Carlson, *Undersecured Claims Under Bankruptcy Code Sections 506(a) and 1111(b): Second Looks at Judicial Valuations of Collateral* (hereinafter "Carlson"), 6 Bankr. Dev. J. 253, 304 (1989)), Congress made at least one thing clear: that a creditor makes this Section 1111(b) election "*notwithstanding* section 506(a)." 11 U.S.C. § 1111(b)(2) (emphasis added). Congress's explicit provision for an exception to Section 506 in Chapter 11 strengthens, rather than undermines, the conclusion that Section 506 is fully available to Chapter 7 debtors seeking to strip down liens.

Congress apparently enacted the Section 1111(b) election to reverse the result in a pre-Code reorganization case, *In re Pine Gate Assoc.*, 2 Bankr. Ct. Dec. (CRR) 1478 (Bankr. N.D. Ga. 1976), involving non-recourse loans.[12] In *Pine Gate*, a reorganizing debtor successfully

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[12] *See In re South Village Inc.*, 25 Bankr. 987, 999 (Bankr. D. Utah 1982); *Stripping Down Liens*, at 74 (Section 1111(b) was designed to address *In re Pine Gate Assoc.*, 2 Bankr. Ct. Dec. (CRR) 1478 (Bankr. N.D. Ga. 1976)). A recourse lender is generally free to sue the borrower for any deficiency resulting from the collateral being worth less than the lender's total claim. A non-recourse lender can look only to the property securing its claim for payment. *See Vintero Corp. v. Corporacion Venezolana de Fomento*, 735 F.2d 740, 742 (2d Cir.), *cert. denied*, 469 U.S. 1087 (1984) ("By pre-

bifurcated claims held by certain non-recourse creditors into secured and unsecured portions and retained the property by tendering to the creditors the appraised value of the property. Because of the non-recourse nature of the claim, the creditors could not pursue a deficiency against the debtor personally and were therefore prevented from receiving anything on their unsecured claims.[13] By enacting Section 1111(b) in 1978, Congress reversed the *Pine Gate* result in Chapter 11 cases by converting non-recourse creditors' claims into recourse claims, thus making the unsecured claims of these creditors eligible for payment out of the estate. *See* 11 U.S.C. § 1111(b)(1)(A). At the same time, Congress gave them the option (the Section 1111(b) election) to surrender their newly-acquired recourse status in the hope of realizing a return on an increase in the collateral's value. *See* 124 Cong. Rec. 32406-07 (1978) (remarks of Rep. Edwards); 124 Cong. Rec. 34006-07 (1978) (remarks of Sen. DeConcini). However, by virtue of Section 1129(b)(2)(A), that hope will be realized only in limited circumstances[14]—where the property is sold after confirmation of the plan[15] or where the debtor defaults under the plan.[16] In all other circumstances, the creditor will receive only the value of the property as of the date of confirmation.[17]

cluding the [non-recourse] party from getting a deficiency judgment against him, the debtor contains the risk of loss to the security alone. . . .").

[13] *See Stripping Down Liens*, at 74; Carlson, at 281.

[14] It is not surprising, therefore, that the election is rarely made. *See In re Shrum*, 98 Bankr. 995, 1003 n.4 (Bankr. W.D.Okla. 1989) (concurring opinion) ("The benefits of the § 1111(b)(2) election are dubious, as its apparent advantages are substantially negated by § 1129(b)(2)(A). . . . The § 1111(b)(2) election is seldom made and it is even less frequently understood.").

[15] *See* Carlson, at 295 (If a sale unexpectedly occurs under the plan, "the electing creditor is entitled to the proceeds 'up to the full amount of the debt.'") (footnote omitted).

[16] *In re Wandler*, 77 Bankr. 728, 732 (Bankr. D.N.D. 1987) *citing In re Southern Mo. Towing Serv., Inc.*, 35 Bankr. 313, 314 (Bankr. W.D. Mo. 1983); *In re Mahaner*, 34 Bankr. 308, 309 (Bankr. W.D.N.Y. 1983).

[17] *See In re Wandler*, 77 Bankr. at 732 ("Upon making an 1111(b) election a creditor . . . has the right to receive the full amount of its allowed claim over time, as long as these payments have a present value as of the effective date of the plan, of at least the value of the creditor's interest in its collateral."); *see also In re Kvamme*, 93 Bankr. 698, 699-700 (Bankr. D.N.D. 1988); 124 Cong. Rec. 32,407 (1978) (statement of Rep. Edwards); 124 Cong. Rec. 34006-07 (1978) (statement of Sen. DeConcini); 5 L. King, *Collier on Bankruptcy*, ¶ 1111.02 at 1111-28 (15th ed. 1990) ("The cash payments [to the electing creditor] however, need only have a present value equal to the value of the debtor's interest in the collateral. . . ."); *Stripping Down Liens*, at 77.

Section 1111(b) demonstrates that Congress knew how to draft an explicit exception to Section 506 that allows certain creditors to prevent the strip down of their liens. Had Congress intended the same treatment for creditors in Chapter 7, it plainly could have enacted the necessary excepting language to achieve this result. As the Third Circuit noted in *Gaglia*, "Section 1111(b)(1) is carefully drawn and uses specific, precise language. It demonstrates that Congress knew how to exempt certain creditors from the operation of § 506, and could do so with precision." 889 F.2d at 1311.

II. THERE IS NO BASIS FOR CONCLUDING THAT SECTION 506(d) APPLIES ONLY TO PERSONAL, BUT NOT REAL, PROPERTY IN CHAPTER 7.

The court of appeals' next argument for avoiding the clear words of Section 506(d)—that Section 722 of the Code makes it "'obvious that Congress did not intend to permit a debtor to redeem his *real* property through the use of § 506(d)'" (Pet. App. 9a-10a (citation omitted; emphasis added))—is equally flawed. The court of appeals was entirely correct in stating that Section 722 is the only "redemption" provision in Chapter 7 and that Sec-

tion 722 applies only to personal property. Pet. App. 9a-10a. But these two statutory facts do not, as the court of appeals asserted, compel the conclusion that Section 506(d) is inapplicable to real property in Chapter 7 cases.

The court's erroneous conclusion flows from its confusion of the concepts of lien avoidance and redemption. Section 506(d) applies broadly to liens on "property" and thus voids liens on both real and personal property. 11 U.S.C. § 506(d).[18] It is not a redemption provision. *Matter of Folendore*, 862 F.2d 1537, 1540 (11th Cir. 1989) ("Section 506(d) does not really 'redeem' the property of the debtor."); *see also Gaglia v. First Federal Sav. & Loan Ass'n*, 889 F.2d at 1310. While Section 506 certainly clears the way for redemption under Section 722, the redemption provision in Section 722 exists for a specific purpose: to address Congress's perceived need to "prevent abuses" peculiar to consumer credit arrangements by enacting a redemption mechanism for personal property that "is broader than rights of redemption under the Uniform Commercial Code." *See* H.R. No. 595, at 380-81, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6336.[19] In short, because of the peculiar concerns of credit

[18] As we have explained (*supra*, at 14-15), Congress specifically intended the term "lien" to encompasses mortgage liens on real property. *See* H.R. Rep. No. 595, at 312, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6269; S. Rep. No. 989, at 25, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 5811 ("liens" include security interests in property). And the majority of bankruptcy courts has agreed. *See* note 3, *supra* (and cases cited therein); 3 L. King, *Collier on Bankruptcy*, ¶ 506.07, at 506-75 (15th ed. 1990).

[19] Congress was fully aware of the potential abuses in the consumer context. *See* H.R. Rep. 595, at 127, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6088. In consumer cases, very often a secured creditor with a security interest in all of the debtor's property, including household and personal goods, used the threat of foreclosure to obtain a reaffirmation of a debt. The secured creditor was able to threaten to deprive a debtor of even the most insignificant household effects, including furniture, cooking utensils, and clothing, even though the items had little if any realizable market value. However, the goods did have a high replacement cost, and thus the creditor was able to use the threat of repossession, rarely carried out, to extract more than he would be able to extract if he foreclosed or repossessed. Section 722's right of redemption "amounts to a right of first refusal in a foreclosure sale of the property involved. It allows the debtor to retain his necessary property and avoid high replacement costs. . . ." *Id.*

arrangements relating to personal property, Congress gave debtors broader rights under the Code than were available under non-bankruptcy law. *Id.*

In contrast to its action with respect to *personal* property, Congress thus did not address redemption of *real* property. The debtor who uses Section 506(d) to avoid a real property lien does not receive, by virtue of the Code, all right, title and interest to the property; instead, the debtor retains his title subject to the creditor's secured claim, which is equal to the value of the property. *See Gaglia v. First Federal Sav. & Loan Ass'n*, 889 F.2d at 1310; *Matter of Folendore*, 862 F.2d 1537. The debtor may, however, be able to redeem the real property by virtue of state law.[20] Section 722 thus does not demonstrate that Congress intended to deprive Chapter 7 debtors of the right to void liens on real property under Section 506(d) and to redeem that property, if possible, under state law.

III. NOTHING IN THE PLAIN LANGUAGE OR STRUCTURE OF THE BANKRUPTCY CODE PRECLUDES THE APPLICATION OF SECTION 506(d)'S STRIP-DOWN PROVISION TO ABANDONED PROPERTY.

Finally, the court of appeals resorted to a "plain language" argument that deprives Section 506(d) of the Bankruptcy Code of one of its central functions. Pet.

[20] Note, *An Individual Debtor's Right To Avoid Liens Under Section 506(d) of the Bankruptcy Code*, 12 Cardozo L. Rev. 263, 277 (1990) ("State law, not the Bankruptcy Code, entitles [the debtor] to buy back encumbered property from secured creditors.") (footnote omitted).

App. 8a. In the court's view, because abandoned property is no longer "property of the estate" under Section 554, the trustee's abandonment of the debtor's real property stripped the estate of any "interest" in that property and deprived the debtor of its right to void a lien on that property under Section 506(d). *Id.* at 5a-8a.

Initially, we note that Congress deliberately chose not to use the term "property of the estate"—a phrase that it had defined and used exhaustively elsewhere in the Code—in Section 506 and opted instead for the phrase "property in which the estate has an interest." Section 506, as currently codified, had its origins in H.R. 6, a bill that Representative Edwards introduced on January 4, 1977. That early version of Section 506 provided that "[a]n allowed claim of a creditor secured by a lien on *property of the estate* is a secured claim to the extent of the value of such creditor's interest in such property, and is an unsecured claim to the extent that such value is less than the amount of such allowed claim." H.R. 6 § 506(a), 95th Cong., 1st Sess. (1977) (emphasis supplied). The drafters clearly knew at the time what they intended "property of the estate" to mean, since they had defined the phrase elsewhere in H.R. 6. *See* H.R. 6 § 541. Nonetheless, on July 11, 1977, when Representative Edwards introduced a substitute bill, H.R. 8200—the bill that Congress eventually amended and enacted—the bill did not mention "property of the estate" in Section 506. Rather, the July 11, 1977 version of H.R. 8200 contained, in its Section 506, the same phrase that currently exists in the statute, i.e., "property in which the estate has an interest." H.R. 8200 § 506(a), 95th Cong., 1st Sess. (1977). Congress's explicit word choice in Section 506(a) demonstrates that "property in which the estate has an interest" connotes something different than "property of the estate."

Section 506's application to overencumbered and abandoned property under Section 722 of the Code, moreover,

demonstrates that Section 506(a)'s reference to "property in which the estate has an interest" includes abandoned property. Section 722 enables an individual Chapter 7 debtor to "redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property . . . has been *abandoned under Section 554* of this title, by paying the holder of such lien the amount of the *allowed secured claim* of such holder that is secured by such lien." 11 U.S.C. § 722 (emphasis supplied). Section 722, by its terms, applies to abandoned property; at the same time, it mandates resort to Section 506—the only mechanism in the Code for valuing and bifurcating claims—to determine the amount of the "allowed secured claim" and, accordingly, the price of redeeming abandoned personal property. *See* 4 L. King, *Collier on Bankruptcy* ¶ 722.05 at 722-7 (15th ed. 1989). Section 722's dependence on Section 506's valuation and bifurcation provisions makes unequivocally clear that Section 506(a)'s reference to "property in which the estate has an interest" must encompass abandoned property that is no longer "property of the estate." [21]

Finally, construing "property in which the estate has an interest" to exclude overencumbered and abandoned property would deprive Section 506(d) of one of its central functions and render the provision entirely meaningless in the situation to which it was most clearly directed. This is so because the very situation that Section 506(d) ad-

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[21] *See* Note, 12 Cardozo L. Rev., *supra* note 20, at 279 ("Because section 722 implicitly directs a bankruptcy court to use section 506(a) to value a claim on abandoned property, the minority's argument [that 506(a) cannot be used to value property that is not part of the estate] is invalid.").

dresses—i.e., where the value of the lien exceeds the value of the collateral—is the exact same situation that gives rise to abandonment. The trustee will typically abandon property when the value of the mortgagee's or judgment lienholder's claim exceeds the value of the property. *See In re Crouch*, 80 Bankr. 364 (Bankr. W.D. Va. 1987) (abandonment appropriate where no equity for unsecured creditors); *In re Manicure*, 29 Bankr. 248 (Bankr. W.D. Va. 1983) (abandonment where little or no equity); *In re A&T Trailer Park, Inc.*, 53 Bankr. 144 (Bankr. D. Wyo. 1985) (abandonment where first mortgage exceeded $480,000 and residence valued at $50,000); 4 L. King, *Collier on Bankruptcy*, ¶ 554.02[5] at 554-11.[22] To hold that abandonment prevents use of Section 506(d) would largely write that provision out of the Code.[23]

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[22] This is what happened in this case. The Dewsnups' property remained "property of the estate" throughout the proceedings in the bankruptcy court, including the trial under Section 506. After the bankruptcy court had valued the property to be less than the respondents' lien, the trustee abandoned the property. J.A. 23-24; Pet. App. 3a n. 2.

[23] If Section 506(d) were held inapplicable to abandoned property, the only possible circumstances in which it could apply would be to void liens where the underlying claim was disallowed under Section 502 and to void liens on exempt property under Section 522(c). Section 506(d), by its own terms, is not limited to the former; and we do not understand the court of appeals to suggest it to be limited to the latter. Obviously, if Section 506(d)'s purpose was to void liens on exempt property only, it would have been far more logical for Congress to include it as a part of Section 522(f), which deals explicitly with lien avoidance on exempt property.

This construction would, of course, have the effect of rendering Section 506(a) "entirely nugatory" (*In re Mays*, 85 Bankr. 955, 961 (Bankr. E.D. Pa.), *aff'd*, 1988 U.S. Dist. LEXIS 8427 (1988)) as well. If abandoned property is not "property in which the estate has an interest" then Section 506(a) also effectively cannot apply to property where the lien exceeds the value of the property.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted,

TIMOTHY B. DYK
(Counsel of Record)
PATRICIA A. DUNN
PATRICK J. POTTER
DEENA B. JENAB
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939
Counsel for Petitioner

April 26, 1991

Called
Will call 1pm

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No. 90-741

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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JOINT APPENDIX

TIMOTHY B. DYK
(Counsel of Record)
PATRICIA A. DUNN
DEENA B. JENAB
PATRICK J. POTTER
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939
Counsel for Petitioner

RICHARD G. TARANTO
(Counsel of Record)
ONEK, KLEIN & FARR
2550 M Street, N.W.
Suite 350
Washington, D.C. 20037
(202) 775-0184

MICHAEL Z. HAYES
MAZURAN, VERHAAREN & HAYES
2180 South 1300 East
Suite 260
Salt Lake City, UT 84106
Counsel for Respondents

EDITOR'S NOTE

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RELEVANT DOCKET ENTRIES

I. United States Bankruptcy Court for the District of Utah

1. January 21, 1987 —Complaint filed
2. March 5, 1987 —Amended Complaint filed
3. March 27, 1987 —Answer to Amended Complaint To Determine Validity of Lien filed
4. June 9, 1987 —Pre-trial Order filed
5. June 11, 1987 —Defendants' Trial Brief filed
6. June 23, 1987 —Plaintiff's Trial Brief filed
7. June 25, 1987 —Pre-trial Order Entered
8. June 25, 1987 —Trial
9. July 1, 1987 —MIN. ENT. filed on TRIAL (held 6/25/87)—Clark) The value of the Deseret property of $28,800 and value of the Oak City property is $10,200.
10. June 15, 1988 —Memorandum Opinion filed
11. August 15, 1988 —Judgment of Dismissal filed
12. September 16, 1988—Notice of Appeal filed

II. United States District Court for the District of Utah

1. March 15, 1989 —Order Affirming Judgment of Bankruptcy Court filed
2. May 15, 1989 —Appeal filed

III. United States Court of Appeals for the Tenth Circuit

1. July 11, 1990 —Opinion filed

IV. United States Supreme Court

1. February 19, 1991 —Petition for Writ of Certiorari granted

IN THE DISTRICT COURT
OF THE FOURTH JUDICIAL DISTRICT
IN AND FOR MILLARD COUNTY
STATE OF UTAH

Civil No. 7191

LOUIS L. TIMM, *et al.*,
Plaintiffs,

vs.

LAMAR DEWSNUP, *et al.*,
Defendants.

NOTICE OF FILING OF PETITION IN BANKRUPTCY AND NOTICE OF AUTOMATIC STAY

[Filed Jul. 25, 1984]

TO THE PLAINTIFF AND THEIR COUNSEL OF RECORD:

PLEASE TAKE NOTICE that on Wednesday, the 27th day of June, 1984, LaMar Dewsnup and Aletha Dewsnup, the defendants herein, filed a Chapter 7 petition in the United States Bankruptcy Court for the District of Utah.

PLEASE TAKE FURTHER NOTICE that the filing of said Chapter 7 petition, under 11 U.S.C. § 362, automatically stays all proceedings against LaMar Dewsnup and Aletha Dewsnup.

DATED this 23rd day of July, 1984.

PRINCE, YEATES & GELDZAHLER

By /s/ Rosalie E. Walker
ROSALIE E. WALKER
Attorneys for LaMar Dewsnup
and Aletha Dewsnup

[Certificate of Service Omitted in Printing]

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

Bankruptcy No. 84C-01746

IN RE: LAMAR DEWSNUP and ALETHA DEWSNUP,
Debtors.

Adversary Proceeding No. 87PC-0116

LAMAR DEWSNUP and ALETHA DEWSNUP,
Plaintiffs,

-vs-

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY, PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,
Defendants.

AMENDED COMPLAINT TO DETERMINE VALIDITY OF LIEN

PARTIES AND JURISDICTION

Plaintiffs complain of Defendants as follows:

1. The Plaintiffs are residents of the State of Utah.

2. Upon information and belief, Plaintiffs allege that Defendants, Louis L. Timm, John Neiuwland and Floyd M. Childs, Trustees of the United Precision Machine and Engineering Company Profit-Sharing Trust are residents of the State of Utah.

3. Upon information and belief Plaintiffs allege that Defendant, ABCO Insurance Agency, Inc., is incorporated under the laws of the State of Utah and has its principal place of business in the State of Utah.

4. Upon information and belief, Plaintiff alleges that Defendant, Joseph L. Henroid, as Trustee for the Annette Jacob Trust, is a resident of the State of Utah.

5. This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334 and 28 U.S.C. § 157(b).

6. This is a core proceeding under the meaning of 28 U.S.C. § 157(b)(2)(K).

7. Venue is proper in this district under 28 U.S.C. §§ 1408 and 1409.

FIRST CAUSE OF ACTION

8. On or about June 1, 1978, Plaintiffs executed a Trust Deed with Defendants as beneficiary and Plaintiffs as Trustor in the amount of $119,000.00.

9. On or about December 3, 1980, Plaintiffs paid in full, the underlying note which is secured by the Trust Deed alleged in paragraph 8 of this Complaint.

10. The debt owed by the Plaintiffs to the Defendants arising from the note secured by the June 1, 1978 Trust Deed has been satisfied in full. The Trust Deed should have been released and is no longer valid.

11. The Trust Deed dated June 1, 1978 with Plaintiffs as Trustor and Defendants as beneficiaries, should be removed from the record on the property of the Plaintiffs.

SECOND CAUSE OF ACTION

12. This Second Cause of Action is alleged alternatively and/or in supplement to the First Cause of Action in this Complaint. Therefore, the allegations contained in

paragraphs 1 through 11 of this Complaint are realleged and made part of this Second Cause of Action.

13. In addition to the Trust Deed mentioned in Plaintiffs' First Cause of Action, Defendants claim to have a judgment lien on Defendants' property in the amount of $49,966.21, plus interest from April, 1981, costs and attorney's fees.

14. Defendants claim that the $49,966.21 judgment is also secured by the Trust Deed mentioned in the First Cause of Action of this Complaint.

15. Defendants claim that their Trust Deed and judgment lien attach to Plaintiffs' property located near Deseret, Utah, specifically described in Exhibit "A" attached hereto, and Plaintiffs' property located near Oak City, Utah, specifically described in Exhibit "B" attached hereto.

16. The value of the 160 acres of Plaintiffs' property located near Deseret, Utah, as of the time of the filing of this action, was $24,000.00.

17. The value of Defendants' property located near Oak City of the 56 acres of Plaintiffs' property located near Oak City, Utah, as of the time of the filing of this action was $8,500.00.

18. Pursuant to 11 U.S.C. § 506(d), the security interests of Defendants, including the Trust Deed and judgment lien, are invalid to the extent that they exceed the value of the debtors' property upon which they attach. The security interests of the Defendants are invalid to the extent they are unsecured.

19. The security interests of the Defendants can be satisfied in full by Plaintiffs remitting to the Defendants the fair market value of the property upon which the security interest attaches. The remainder of Defendants' claims against Plaintiffs are unsecured.

THIRD CAUSE OF ACTION

20. This cause of action is alleged as an alternative and/or supplement to the first two causes of action alleged in this Complaint. Therefore, Plaintiffs reallege the allegations made in paragraphs 1 through 19 and incorporate them as part of this cause of action.

21. Defendants obtained a judgment against Plaintiffs on April 24, 1981.

22. Plaintiffs filed a Chapter 11 bankruptcy case in the United States Bankruptcy Court for the District of Utah on April 22, 1981.

23. The judgment and judgment lien obtained by Defendants in April of 1981 are void under 11 U.S.C. § 362 as they were entered after Plaintiffs filed their Petition in bankruptcy.

WHEREFORE, debtors pray that:

1. The Court enter an order removing the June 1, 1978 Trust Deed, with Defendants as beneficiary, from the property of the debtors because the underlying note has been satisfied and the Trust Deed is invalid.

2. The Court enter an order avoiding Defendants' security interest on the real property of the Plaintiffs to the extent that the security interest exceeds the value of the real property under 11 U.S.C. § 506(d).

3. The Court enter an order voiding the April 24, 1981 judgment in favor of Defendants under 11 U.S.C. § 362.

4. For such other relief as the Court deems appropriate under the circumstances.

DATED this 3rd day of March, 1987.

McKAY, BURTON & THURMAN

By /s/ William Thomas Thurman
WILLIAM THOMAS THURMAN
SCOTT C. PIERCE
Attorneys for Debtors

[Certificate of Service Omitted in Printing]

EXHIBIT "A"

Parcel 3:

The Southwest quarter of the Northeast quarter; the Northwest quarter of the Southeast quarter; the Southeast quarter of the Northwest quarter and the Northeast quarter of the Southwest quarter of Section 13, Township 18 South, Range 8 West, Salt Lake Base and Meridian.

EXCEPTING THEREFROM that portion lying within the boundaries of the County Road right-of-way.

EXCEPTING THEREFROM (Parcel 3) all rights of way, stock trails, ditches and canals, gravel pits and gravel beds.

* * * *

EXHIBIT "B"

The land referred to in this report is situated in the County of Millard, State of Utah, and is described as follows:

Parcel 1:

Beginning 980 feet West of the Southeast corner of the Southwest quarter of Section 4, Township 17 South, Range 4 West, Salt Lake Base and Meridian, thence North 1320 feet; thence West 1264 feet; thence South 625 feet, more or less, to the North boundary of Road right-of-way; thence Southeasterly along the Road right-of-way 541 feet; thence South 470 feet; thence East 840 feet to the point of beginning.

Parcel 2:

Beginning 980 feet West of the Northeast corner of the Northwest quarter of Section 9, Township 17 South, Range 4 West, Salt Lake Base and Meridian; thence South 1320 feet; thence West 840 feet; thence North 1320 feet; thence East 840 feet to the point of beginning.

EXCEPTING THEREFROM that portion lying within the boundaries of the County Road right-of-way.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

Bankruptcy No. 84C-01746

IN RE: LAMAR DEWSNUP and ALETHA DEWSNUP,
Debtors.

Adversary Proceeding No. 87PC-0116

LAMAR DEWSNUP and ALETHA DEWSNUP,
Plaintiffs,

vs.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY, PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,
Defendants.

ANSWER TO AMENDED COMPLAINT TO DETERMINE VALIDITY OF LIEN

COME NOW, Defendants, by and through their attorney Michael Z. Hayes, and hereby answer Plaintiffs' Amended Complaint to Determine Validity of Lien as follows:

FIRST DEFENSE

1. Plaintiffs' Complaint and the whole thereof fails to state a cause of action upon which relief may be granted.

SECOND DEFENSE

2. In answer to the specific paragraphs of Plaintiffs' Complaint, Defendants admit paragraphs 1 through 8, and 13, 14, 15, 21 and 22 of Plaintiffs' Complaint.

3. Defendants deny paragraphs 9, 10, 11, 16, 17, 18, 19, 22, and 23 of Plaintiffs' Complaint.

4. In answer to paragraphs 12 and 20 of Plaintiffs' Complaint, Defendants reallege their answers to the other numbered paragraphs of said Complaint.

5. Defendants deny each and every allegation of the Complaint not heretofore admitted, denied or modified.

AFFIRMATIVE DEFENSE

6. As an affirmative defense to Plaintiffs' Third Cause of Action Defendants allege that the Chapter 11 Bankruptcy Case filed on April 22, 1981 was subsequently dismissed by this Court, having the affect under bankruptcy law of returning the parties to their respective conditions immediately before the filing, which in effect, reinstated Defendant's Judgment against Plaintiffs.

WHEREFORE, having fully answered Plaintiffs' Complaint, Defendants pray that the same be dismissed with prejudice, Plaintiffs' taking nothing thereby, and that these Defendants be awarded their costs incurred in defending this action and further that they be awarded the relief presently requested by them in this Court for relief from stay and an order allowing them to proceed with the foreclosure proceedings on Plaintiffs' property.

DATED this 26th day of March, 1987.

/s/ Michael Z. Hayes
MICHAEL Z. HAYES

[Certificate of Service Omitted in Printing]

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

Bankruptcy No. 84C-01746

IN RE: LAMAR DEWSNUP and ALETHA DEWSNUP,
Debtors.

Adversary Proceeding No. 87PC-0016

LAMAR DEWSNUP and ALETHA DEWSNUP,
Plaintiffs,

vs.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY, PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,
Defendants.

PRE-TRIAL ORDER

Based upon a stipulation of the parties and the Bankruptcy Rules of Procedure, the following Pre-Trial Order is entered by the Court.

1. *JURISDICTION.* The jurisdiction of this Court is based upon 28 U.S.C. § 1334 and 28 U.S.C. § 157(b). This matter is a core proceeding under the meaning of 28 U.S.C. § 57(b)(2)(k). Jurisdiction is not disputed and is hereby determined to be present.

2. *VENUE.* Venue is proper in this District under 28 U.S.C. §§ 1408 and 1409. Venue is not in dispute and is hereby determined to be proper.

3. *GENERAL NATURE OF PARTIES' CLAIMS.*

(a) *Plaintiffs' Claims.*

(1) On or about June 1, 1978, Plaintiffs executed a deed of trust with Defendants as beneficiary and Plaintiffs as trustor in the amount of $119,000.00.

(2) On or about December 3, 1980, Plaintiffs paid, in full, the underlying note which was secured by the Trust Deed dated June 1, 1978.

(3) The Trust Deed dated June 1, 1978 still appears of record against Plaintiffs' property and has never been released. Plaintiffs claim that the Trust Deed dated June 1, 1978 should have been released upon payment in December of 1980. Plaintiffs seek to have this trust deed removed as against Plaintiffs' property by court order in this action.

(4) Plaintiffs claim that pursuant to 11 U.S.C. § 506 (d) that in any event, the trust deed and judgment lien currently of record, to which Defendants are beneficiaries, are invalid to the extent that they exceed the value of Plaintiff's property. Therefore, the security interest of Defendants can be satisfied in full by Plaintiffs remitting to Defendants the fair market value of the property upon which the security interest attaches. In other words, Plaintiffs can redeem the property by paying to Defendants the fair market value of the property even if Defendants trust deed and lien are determined to be valid by the Court. The remaining claims Defendants may have against Plaintiffs are unsecured.

(5) Plaintiffs claim that Defendants' judgment and judgment lien obtained in April of 1981 are void and of no effect under 11 U.S.C. § 362 because the judgment was entered after Defendants filed bankruptcy on April 22, 1981.

(b) *Defendant's Claims.*

(1) Defendants deny that Plaintiffs paid the Trust Deed dated June 1, 1978 in full on or about December 3, 1980. Defendants claim that they paid additional money pursuant to a document entitled "Assignment of Contract" dated June 1, 1978 whereby Defendants paid a sum of money to bring the contract current and claim that amount was added to the note secured by the deed of trust.

(2) Additionally, Defendants claim that they have a judgment lien on the property in the amount of the judgment which was signed April 22, 1981 and entered by the Court Clerk April 24, 1981, and deny that that judgment is void under 11 U.S.C. § 362 because the bankruptcy case filed on April 22, 1981 was subsequently dismissed and further that Plaintiffs have either waived or are estopped from claiming the judgment is void in these proceedings.

(3) Defendants deny that Plaintiffs may redeem the property by paying to Defendants the fair market value and thereby avoiding the remainder of Defendants' lien.

4. *UNCONTESTED FACTS.* The following facts are established by admissions in the pleadings or by stipulation of counsel.

(a) On or about June 1, 1978, Plaintiffs executed a Trust Deed with Defendants as beneficiary and Plaintiffs as trustor in the amount of $119,000.00.

(b) On or about December 3, 1980, Plaintiffs paid to Defendants' attorney the sum of $151,013.89 through the trust account of Plaintiffs' former attorney, Robert Fillerup, on or about December 3, 1980 and December 8, 1980.

(c) The property effected by the trust deed and Defendants' subsequent judgment lien is in two parcels which are described in Exhibits "A" and "B" attached hereto.

(d) Plaintiffs and Defendants entered into an agreement dated June 1, 1978 entitled Assignment of Contract, whereunder Plaintiffs assigned to Defendants all of their interest in a contract of sale for real property entered into with Arrow Investment Company, Ltd., as sellers and Plaintiffs as buyers. The agreement specifically states that its purpose is to secure the three notes of $56,000.00 to ABCO Insurance; $33,000.00 to Joseph L. Henriod, Trustee for the Annette Jacob Trust and $30,000.00 to the United Machine and Engineering Company Profit-Sharing Trust, which notes were also secured by the Trust Deed on the property as mentioned above.

(e) In an attempt to protect the additional security for the loan, Defendants expended an additional Forty-seven Thousand Eight Hundred Eighty Dollars and Fifty Cents ($47,880.50) to bring the first mortgage current on the property relating to the Arrow Investment Co. contract. In addition, Defendants paid two Thousand Eighty-five Dollars and Seventy-one Cents ($2,085.71) for back taxes to the Millard County Treasurer.

(f) Defendants filed a complaint on or about September 16, 1980 in which they sought to foreclose Plaintiffs' interest in the real property attached as Exhibits "A" and "B" and for other claims. On or about March 3, 1981, Plaintiffs filed a motion for summary judgment in that action.

(g) On April 22, 1981, Plaintiffs filed for bankruptcy in the United States Bankruptcy Court for the District of Utah.

(h) On April 14, 1981, Defendants Motion for Summary Judgment was heard and granted by Judge J. Harlan Burns. Judge Burns signed the Judgment April 22, 1981, and it was entered by the Court Clerk on April 24, 1981.

(i) Plaintiffs' first Bankruptcy was dismissed on April 1, 1982. A subsequent Bankruptcy was dismissed with

prejudice on February 13, 1984. Subsequently Plaintiffs filed the present Chapter 7 case which is now pending before the Court.

5. *CONTESTED ISSUES OF FACT.*

(a) Whether or not the debt owed to Defendants pursuant to the Assignment of Contract entered into by the parties on June 1, 1978, where Defendants paid a sum of money to bring a contract current, was secured by the Trust Deed dated June 1, 1978.

(b) Whether or not Plaintiffs' payment to Defendants on or about December 3 and 8, 1980, paid in full the notes and all obligations which were secured by the Trust Deed dated June 1, 1978.

(c) What is the fair market value of the Plaintiffs' property described in Exhibits "A" and "B"?

6. *CONTESTED ISSUES OF LAW.*

(a) Is the summary judgment signed by Judge Burns on April 22, 1981 and entered in favor of Defendants by the Fifth District Court for the State of Utah on April 24, 1981, two days after Plaintiffs filed a Chapter 11 bankruptcy, null and void under 11 U.S.C. Section 362 as being in violation of the automatic stay?

(b) What effect did the Dismissal of Plaintiffs' Bankruptcy have on the Judgment obtained by Defendants against Plaintiffs?

(c) Are Plaintiffs either estopped or barred from bringing this action in the current Bankruptcy Proceeding before the Court?

(d) In the event that the summary judgment granted in favor of Defendants on April 24, 1981 is valid, did it create additional debt that was secured by the Trust Deed dated June 1, 1978?

(e) Are Defendants' security interests invalid to the extent they vceed the value of the debtors' property upon which they attach, and can the Debtors/Defendants satisfy Defendants' security interest by tendering to Defendants the market value of the property?

7. *EXHIBITS.* The following exhibits will be in the absence of reasonable notice, submitted into evidence at trial by the parties. The parties hereby stipulate to the authenticity of these exhibits, but reserve objections to the admittance of the exhibits into evidence:

(a) Plaintiffs' Exhibits:

(1) Trust Deed dated June 1, 1978.

(2) The notes secured by the Trust Deed dated June 1, 1978.

(3) Copy of a check dated December 3, 1980 in the amount of $147,613.89 payable to Wendell E. Bennett, attorney at law.

(4) A check dated December 8, 1980 in the amount of $3,400.00 payable to Robert C. Fillerup in reference paid pursuant to the Dewsnup settlement.

(5) A copy of the Assignment of Contract entered into between the parties dated June 1, 1978.

(6) Summary judgment granted in favor of Defendants in the Fifth Judicial District Court for Millard County, State of Utah, Case No. 7191 entered on April 24, 1981.

(b) Defendants' Exhibits:

(1) Findings of Fact, Conclusions of Law and Order regarding Dismissal of Plaintiffs' Bankruptcy Case #82C-02046, dated February 13, 1984.

(2) Disclosure Statement of Plaintiffs in Bankruptcy #82C-02046, dated June 22, 1983.

(3) Stipulation and Order in Bankruptcy #82C-02046, dated May 25, 1983.

(4) Order of Dismissal in Plaintiffs' Bankruptcy Case #81-01367, dated April 1, 1982.

(5) Letter from Wendell Bennett to Robert Fillerup dated April 15, 1981.

(6) Letter from Wendell Bennett to Robert Fillerup dated April 9, 1981.

(7) Letter from Wendell Bennett to Robert Fillerup dated February 27, 1981.

(8) Letter from Wendell Bennett to Robert Fillerup dated December 19, 1980.

(9) Letter from Wendell Bennett to Robert Fillerup dated November 24, 1980.

(c) Exhibits received in evidence may be withdrawn from the Clerk's office upon signing of receipts therefor by the respective parties offering them to be returned to the Clerk's office within a reasonable time and in the meantime, to be available for inspection at the request of other parties. Exhibits which have not been received, but which are hereby identified, shall be presented to, and marked for identification by the Clerk of the Court prior to trial.

(d) Except as otherwise indicated, the authenticity of the foregoing exhibits have been stipulated but they have been received subject to objections, if any, by the opposing counsel at the trial as to the relevancy and materiality.

8. *WITNESSES.*

(a) In the absence of reasonable notice to opposing counsel to the contrary, Plaintiffs will call as witnesses:

Aletha Dewsnup

Robert Fillerup

(b) In the absence of reasonable notice to opposing counsel to the contrary, Defendants will call as witnesses:

Wendell Bennett

(c) In the event that other witnesses are to be called, their names and addresses and the general subject matter of their testimony will be served upon opposing counsel and filed with the Court at least three (3) days prior to trial. This restriction shall not apply to rebuttal witnesses, the necessity of whose testimony reasonably cannot be anticipated before the time of trial.

9. *REQUESTS FOR INSTRUCTION.* This case is to be tried by the Court.

10. *AMENDMENTS TO PLEADINGS.* There are no requests to amend pleadings.

11. *DISCOVERY.* Discovery has been completed.

12. *TRIAL SETTING.* The case has been set for trial without jury on June 25, 1987 beginning at 9:00 o'clock a.m.

13. *SETTLEMENT.* Counsel has conferred respecting settlement of this matter and settlement is considered poor. Trial will not be postponed to allow the conduct of further settlement negotiations except upon a showing of good cause.

DATED this — day of June, 1987.

BY THE COURT:

GLEN E. CLARK
U.S. Bankruptcy Court Judge

McKAY, BURTON & THURMAN

By /s/ William Thomas Thurman
WILLIAM THOMAS THURMAN
SCOTT C. PIERCE
Attorneys for Plaintiffs

MAZURAN, VERHAAREN & HAYES

By /s/ Michael Z. Hayes
MICHAEL Z. HAYES
Attorneys for Defendants

EXHIBIT "A"

Parcel 3:

The Southwest quarter of the Northeast quarter; the Northwest quarter of the Southeast quarter; the Southeast quarter of the Northwest quarter and the Northeast quarter of the Southwest quarter of Section 13, Township 18 South, Range 8 West, Salt Lake Base and Meridian.

EXCEPTING THEREFROM that portion lying within the boundaries of the County Road right-of-way.

EXCEPTING THEREFROM (Parcel 3) all rights of way, stock trails, ditches and canals, gravel pits and gravel beds.

• • • •

EXHIBIT "B"

The land referred to in this report is situated in the County of Millard, State of Utah, and is described as follows:

Parcel 1:

Beginning 980 feet West of the Southeast corner of the Southwest quarter of Section 4, Township 17 South, Range 4 West, Salt Lake Base and Meridian, thence North 1320 feet; thence West 1264 feet; thence South 625 feet, more or less, to the North boundary of Road right-of-way; thence Southeasterly along the Road right-of-way 541 feet; thence South 470 feet; thence East 840 feet to the point of beginning.

Parcel 2:

Beginning 980 feet West of the Northeast corner of the Northwest quarter of Section 9, Township 17 South, Range 4 West, Salt Lake Base and Meridian; thence South 1320 feet; thence West 840 feet; thence North 1320 feet; thence East 840 feet to the point of beginning.

EXCEPTING THEREFROM that portion lying within the boundaries of the County Road right-of-way.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH

Use of form: This form is to be used only in asset cases. It must be submitted, in duplicate, to the trustee (not the court). If mailed, the creditor must include a stamped, self-addressed envelope. Important: Even if the trustee signs the notice of abandonment, the creditor should not take any action against the debtor without first determining that such action is not prohibited by 11 U.S.C. § 362(c).

REQUEST FOR ABANDONMENT

Debtor's Name—Lamar Dewsnup & Aletha Dewsnup

Bankruptcy #84C-01746

Trustee—Roger Segal

Description of Secured Property—Real Property described on Exhibit A & B attached.

Value of Property—$39,000

Basis of Valuation—Book, Appraisal, Estimate, Other—Bankruptcy Court Valuation

Amount Owed to Creditor on Secured Obligation—$49,966.21 + Interest & Att. Fees from 6/2/80.

The above information is true to the best of my knowledge and belief. Attached to this request are documents that reflect a properly perfected security interest in the property listed above. As a secured creditor, I request that the trustee abandon the property from the bank-

ruptcy estate, subject to any interest of the debtor, and issue a written notice of abandonment.

/s/ Michael Z. Hayes
Creditor's Signature
Attorney for United Precision Machine & Engineering Company Profit Sharing Trust, ABCO Insurance Agency, Inc. and Joseph L. Henroid, Trustee for the Annette Jacob Trust.

MICHAEL Z. HAYES
Printed Name
2180 South 1300 East, #260
Address
Salt Lake City, UT
484-6161
Telephone No.
84106
Zip Code

NOTICE OF ABANDONMENT

Pursuant to 11 U.S.C. § 554, I have found the above listed property burdensome to the estate, or of inconsequential value to the estate. I have given notice of my intent to abandon such property during the meeting of creditors, and there being no objection, or request for hearing, the trustee hereby abandons any interest that the estate may have in and to said property.

DATE: July 11, 1988

/s/ [Illegible]
Trustee

EXHIBIT 'A'

BEGINNING 980 feet West of the Southeast Corner of the Southwest ¼ of Section 4, Township 17 South, Range 4 West, Salt Lake Base & Meridian; thence North 1320 feet; thence West 1264 feet; thence South 625 feet; thence Southeasterly along the roadway 541 feet; thence South 470 feet; thence East 840 feet to beginning. More or less 35 Acres.

BEGINNING 980 feet West of the Northeast Corner of the Northwest ¼ of Section 9, Township 17 South, Range 4 West, Sale Lake Base & Meridian; thence South 1320 feet; thence West 840 feet; thence North 1320 feet; thence East 840 feet to beginning. More or less 25 Acres.

EXHIBIT 'B'

The Southwest quarter of the Northeast quarter; of the Northwest quarter of the Southeast quarter; the Southeast quarter of the Northwest quarter; and the Northeast quarter of the Southwest quarter of Section 13, Township 18 South, Range 8 West, Salt Lake Base and Meridian.

EXCEPTION THEREFROM that portion which lies within the boundaries of the DELTA CANAL COMPANY, MELVILLE IRRIGATION COMPANY, ABRAHAM IRRIGATION COMPANY and the DESERET IRRIGATION COMPANY distribution systems.

EXCEPTING THEREFROM all rights of way, stock trails, ditches and canals, gravel pits and gravel beds.

WHEN RECORDED, MAIL TO:
EARL JAY PECK
NIELSEN, HENRIOD, GOTTFREDSON & PECK
116 410 Newhouse Building
Salt Lake City, Utah 84111
521-3350

Space Above This Line For Recorder's Use

A M E N D E D

TRUST DEED

With Assignment of Rents

THIS TRUST DEED, made this 1st day of June, 19 78

between T. LaMAR DEWSNUP and ALETHA DEWSNUP

, as TRUSTOR,

whose address is DESERET UTAH
(Street and number) (City) (State)

EARL JAY PECK, as TRUSTEE,* and
UNITED PRECISION MACHINE & ENGINEERING COMPANY PROFIT SHARING TRUST, ABCO INSURANCE AGENCY, INC. and JOSEPH L. HENRIOD, as trustee for the Annette Jacob Trust
, as BENEFICIARY,

WITNESSETH: That Trustor CONVEYS AND WARRANTS TO TRUSTEE IN TRUST,

WITH POWER OF SALE, the following described property, situated in Millard County, State of Utah:

PARCEL ONE: See Exhibit 'A' hereto
PARCEL TWO: See Exhibit 'B' hereto

25008
REQUESTED AT REQUEST OF
Nielsen, Henriod, Gottfredson & Peck
DATE June 9, 1978 TIME 2:30 P.M.
BOOK 128 OF REC. PAGE 116-121 FEE $ 10.00
Kathy Martin
RECORDER OF MILLARD COUNTY, UTAH
By Lorraine Stapley Deputy

Together with all buildings, fixtures and improvements thereon and all water rights, rights of way, easements, rents, issues, profits, income, tenements, hereditaments, privileges and appurtenances thereunto belonging, now or hereafter used or enjoyed with said property, or any part thereof. SUBJECT, HOWEVER, to the right, power and authority hereinafter given to and conferred upon Beneficiary to collect and apply such rents, issues, and profits;

FOR THE PURPOSE OF SECURING (1) payment of the indebtedness evidenced by a promissory notesof even date herewith, in the principal sum of $ 33,000; $56,000 & $30,000, made by Trustor, payable to the order of Beneficiary at the times, in the manner and with interest as therein set forth, and any extensions and/or renewals or modifications thereof; (2) the performance of each agreement of Trustor herein contained; (3) the payment of such additional loans or advances as hereafter may be made to Trustor, or his successors or assigns, when evidenced by a promissory note or notes reciting that they are secured by this Trust Deed; and (4) the payment of all sums expended or advanced by Beneficiary under or pursuant to the terms hereof, together with interest thereon as herein provided.

*NOTE: Trustee must be a member of the Utah State Bar, a bank, building and loan association or savings and loan association authorized to do such business in Utah; a corporation authorized to do a trust business in Utah; or a title insurance or abstract company authorized to do such business in Utah.

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TO PROTECT THE SECURITY OF THIS TRUST DEED, TRUSTOR AGREES:

1. To keep said property in good condition and repair; not to remove or demolish any building thereon; to complete or restore promptly and in good and workmanlike manner any building which may be constructed damaged or destroyed thereon; to comply with all laws, covenants and restrictions affecting said property; not to commit or permit waste thereof; not to commit, suffer or permit any act upon said property in violation of law; to do all other acts which from the character or use of said property may be reasonably necessary, the specific enumerations herein not excluding the general; and, if the loan secured hereby or any part thereof is being obtained for the purpose of financing construction of improvements on said property, Trustor further agrees:

(a) To commence construction promptly and to pursue same with reasonable diligence to completion in accordance with plans and specifications satisfactory to Beneficiary, and

(b) To allow Beneficiary to inspect said property at all times during construction.

Trustee, upon presentation to it of an affidavit signed by Beneficiary, setting forth facts showing a default by Trustor under this numbered paragraph, is authorized to accept as true and conclusive all facts and statements therein, and to act thereon hereunder.

2. To provide and maintain insurance, of such type or types and amounts as Beneficiary may require, on the improvements now existing or hereafter erected or placed on said property. Such insurance shall be carried in companies approved by Beneficiary with loss payable clauses in favor of and in form acceptable to Beneficiary. In event of loss, Trustor shall give immediate notice to Beneficiary, who may make proof of loss, and each insurance company concerned is hereby authorized and directed to make payment for such loss directly to Beneficiary instead of to Trustor and Beneficiary jointly, and the insurance proceeds, or any part thereof, may be applied by Beneficiary, at its option, to reduction of the indebtedness hereby secured or to the restoration or repair of the property damaged.

3. To deliver to, pay for and maintain with Beneficiary until the indebtedness secured hereby is paid in full, such evidence of title as Beneficiary may require, including abstracts of title or policies of title insurance and any extensions or renewals thereof or supplements thereto.

4. To appear in and defend any action or proceeding purporting to affect the security hereof, the title to said property, or the rights or powers of Beneficiary or Trustee; and should Beneficiary or Trustee elect to also appear in or defend any such action or proceeding, to pay all costs and expenses, including cost of evidence of title and attorney's fees in a reasonable sum incurred by Beneficiary or Trustee.

5. To pay at least 10 days before delinquency all taxes and assessments affecting said property, including all assessments upon water company stock and all rents, assessments and charges for water, appurtenant to or used in connection with said property; to pay, when due, all encumbrances, charges, and liens with interest, on said property or any part thereof, which at any time appear to be prior or superior hereto; to pay all costs, fees, and expenses of this Trust.

6. Should Trustor fail to make any payment or to do any act as herein provided, then Beneficiary or Trustee, but without obligation so to do and without notice to or demand upon Trustor and without releasing Trustor from any obligation hereof, may: Make or do the same in such manner and to such extent as either may deem necessary to protect the security hereof. Beneficiary or Trustee being authorized to enter upon said property for such purposes; commence, appear in and defend any action or proceeding purporting to affect the security hereof or the rights of powers of Beneficiary or Trustee; pay, purchase, contest, or compromise any encumbrance, charge or lien which in the judgment of either appears to be prior or superior hereto; and in exercising any such powers, incur any liability, expend whatever amounts in its absolute discretion it may deem necessary therefor, including cost of evidence of title, employ counsel, and pay his reasonable fees.

7. To pay immediately and without demand all sums expended hereunder by Beneficiary or Trustee, with interest from date of expenditure at the rate of ten per cent (10%) per annum until paid, and the repayment thereof shall be secured hereby.

IT IS MUTUALLY AGREED THAT:

8. Should said property or any part thereof be taken or damaged by reason of any public improvement or condemnation proceeding, or damaged by fire, or earthquake, or in any other manner, Beneficiary shall be entitled to all compensation, awards, and other payments or relief therefor, and shall be entitled at its option to commence, appear in and prosecute in its own name, any action or proceedings, or to make any compromise or settlement, in connection with such taking or damage. All such compensation, awards, damages, rights of action and proceeds, including the proceeds of any policies of fire and other insurance affecting said property, are hereby assigned to Beneficiary, who may, after deducting therefrom all its expenses, including attorney's fees, apply the same on any indebtedness secured hereby. Trustor agrees to execute such further assignments of any compensation, award, damages, and rights of action and proceeds as Beneficiary or Trustee may require.

9. At any time and from time to time upon written request of Beneficiary, payment of its fees and presentation of this Trust Deed and the note for endorsement (in case of full reconveyance, for cancellation and retention), without affecting the liability of any person for the payment of the indebtedness secured hereby, Trustee may (a) consent to the making of any map or plat of said property; (b) join in granting any easement or creating any restriction thereon; (c) join in any subordination or other agreement affecting this Trust Deed or the lien or charge thereof; (d) reconvey, without warranty, all or any part of said property. The grantee in any reconveyance may be described as "the person or persons entitled thereto", and the recitals therein of any matters or facts shall be conclusive proof of truthfulness thereof. Trustor agrees to pay reasonable Trustee's fees for any of the services mentioned in this paragraph.

10. As additional security, Trustor hereby assigns Beneficiary, during the continuance of these trusts, all rents, issues, royalties, and profits of the property affected by this Trust Deed and of any personal property located thereon. Until Trustor shall default in the payment of any indebtedness secured hereby or in the performance of any agreement hereunder, Trustor shall have the right to collect all such rents, issues, royalties, and profits earned prior to default as they become due and payable. If Trustor shall default as aforesaid, Trustor's right to collect any of such moneys shall cease and Beneficiary shall have the right, with or without taking possession of the property affected hereby, to collect all rents, royalties, issues, and profits. Failure or discontinuance of Beneficiary at any time or from time to time to collect any such moneys shall not in any manner affect the subsequent enforcement by Beneficiary of the right, power, and authority to collect the same. Nothing contained herein, nor the exercise of the right by Beneficiary to collect, shall be, or be construed to be, an affirmation by Beneficiary of any tenancy, lease or option, nor an assumption of liability under, nor a subordination of the lien or charge of this Trust Deed to any such tenancy, lease or option.

11. Upon any default by Trustor hereunder, Beneficiary may at any time without notice, either in person, by agent, or by a receiver to be appointed by a court (Trustor hereby consenting to the appointment of Beneficiary as such receiver), and without regard to the adequacy of any security for the indebtedness hereby secured, enter upon and take possession of said property or any part thereof, in its own name sue for or otherwise collect said rents, issues, and profits, including those past due and unpaid, and apply the same, less costs and expenses of operation and collection, including reasonable attorney's fees, upon any indebtedness secured hereby, and in such order as Beneficiary may determine.

12. The entering upon and taking possession of said property, the collecton of such rents, issues, and profits, or the proceeds of fire and other insurance policies, or compensation or awards for any taking or damage of said property, and the application or release thereof as aforesaid, shall not cure or waive any default or notice of default hereunder or invalidate any act done pursuant to such notice.

13. The failure on the part of Beneficiary to promptly enforce any right hereunder shall not operate as a waiver of such right and the waiver by Beneficiary of any default shall not constitute a waiver of any other or subsequent default.

14. Time is of the essence hereof. Upon default by Trustor in the payment of any indebtedness secured hereby or in the performance of any agreement hereunder, all sums secured hereby shall immediately become due and payable at the option of Beneficiary. In the event of such default, Beneficiary may execute or cause Trustee to execute a written notice of default and of election to cause said property to be sold to satisfy the obligations hereof, and Trustee shall file such notice for record in each county wherein said property or some part or parcel thereof is situated. Beneficiary also shall deposit with Trustee, the note and all documents evidencing expenditures secured hereby.

15. After the lapse of such time as may then be required by law following the recordation of said notice of default, and notice of default and notice of sale having been given as then required by law, Trustee, without demand on Trustor, shall sell said property on the date and at the time and place designated in said notice of sale, either as a whole or in separate parcels, and in such order as it may determine (but subject to any statutory right of Trustor to direct the order in which such property, if consisting of several known lots or parcels, shall be sold), at public auction to the highest bidder, the purchase price payable in lawful money of the United States at the time of sale. The person conducting the sale may, for any cause he deems expedient, postpone the sale from time to time until it shall be completed and, in every case, notice of postponement shall be given by public declaration thereof by such person at the time and place last appointed for the sale; provided, if the sale is postponed for longer than one day beyond the day designated in the notice of sale, notice thereof shall be given in the same manner as the original notice of sale. Trustee shall execute and deliver to the purchaser its Deed conveying said property so sold, but without any covenant or warranty, express or implied. The recitals in the Deed of any matters or facts shall be conclusive proof of the truthfulness thereof. Any person, including Beneficiary, may bid at the sale. Trustee shall apply the proceeds of the sale to payment of (1) the costs and expenses of exercising the power of sale and of the sale, including the payment of the Trustee's and attorney's fees; (2) cost of any evidence of title procured in connection with such sale and revenue stamps on Trustee's Deed, (3) all sums expended under the terms hereof, not then repaid, with accrued interest at 10% per annum from date of expenditure; (4) all other sums then secured hereby; and (5) the remainder, if any, to the person or persons legally entitled thereto, or the Trustee, in its discretion, may deposit the balance of such proceeds with the County Clerk of the county in which the sale took place.

16. Upon the occurrence of any default hereunder, Beneficiary shall have the option to declare all sums secured hereby immediately due and payable and foreclose this Trust Deed in the manner provided by law for the foreclosure of mortgages on real property and Beneficiary shall be entitled to recover in such proceeding all costs and expenses incident thereto, including a reasonable attorney's fee in such amount as shall be fixed by the court.

17. Beneficiary may appoint a successor trustee at any time by filing for record in the office of the County Recorder of each county in which said property or some part thereof is situated, a substitution of trustee. From the time the substitution is filed for record, the new trustee shall succeed to all the powers, duties, authority and title of the trustee named herein or of any successor trustee. Each such substitution shall be executed and acknowledged, and notice thereof shall be given and proof thereof made, in the manner provided by law.

18. This Trust Deed shall apply to, inure to the benefit of, and bind all parties hereto, their heirs, legatees, devisees, adminstrators, executors, successors and assigns. All obligations of Trustor hereunder are joint and several. The term "Beneficiary" shall mean the owner and holder, including any pledgee, of the note secured hereby. In this Trust Deed, whenever the context requires, the masculine gender includes the feminine and/or neuter, and the singular number includes the plural.

19. Trustee accepts this Trust when this Trust Deed, duly executed and acknowledged, is made a public record as provided by law. Trustee is not obligated to notify any party hereto of pending sale under any other Trust Deed or of any action or proceeding in which Trustor, Beneficiary, or Trustee shall be a party, unless brought by Trustee.

20. This Trust Deed shall be construed according to the laws of the State of Utah

21. The undersigned Trustor requests that a copy of any notice of default and of any notice of sale hereunder be mailed to him at the address hereinbefore set forth.

Signature of Trustor

I. LaMar Dewsnup

Martha Dewsnup

(If Trustor an Individual)

STATE OF UTAH
COUNTY OF) ss.

On the 1st day of June, A.D. 1978, personally appeared before me I. LaMar Dewsnup & Martha Dewsnup, the signer(s) of the above instrument, who duly acknowledged to me that they executed the same.

Notary Public residing at: Duchesne, Utah

My Commission Expires:
Nov. 4, 1980

(If Trustor a Corporation)

STATE OF UTAH
COUNTY OF) ss.

On the ..... day of ....., A.D. 19....., personally appeared before me ....., who being by me duly sworn, says that he is the ..... of ....., the corporation that executed the above and foregoing instrument and that said instrument was signed in behalf of said corporation by authority of its by-laws (or by authority of a resolution of its board of directors) and said ..... acknowledged to me that said corporation executed the same.

Notary Public residing at:

My Commission Expires:

REQUEST FOR FULL RECONVEYANCE

(To be used only when indebtedness secured hereby has been paid in full)

TO: TRUSTEE.

The undersigned is the legal owner and holder of the note and all other indebtedness secured by the within Trust Deed. Said note, together with all other indebtedness secured by said Trust Deed has been fully paid and satisfied; and you are hereby requested and directed, on payment to you of any sums owing to you under the terms of said Trust Deed, to cancel said note above mentioned, and all other evidences of indebtedness secured by said Trust Deed delivered to you herewith, together with the said Trust Deed, and to reconvey, without warranty, to the parties designated by the terms of said Trust Deed, all the estate now held by you thereunder.

Dated ....., 19.....

.....

.....

Mail reconveyance to .....

TRUST DEED

With Assignment of Rents

.....

.....

.....

.....

.....

TO

AS TRUSTEE FOR

.....

.....

.....

.....

Dated ....., 19.....

FORM 142—TRUST DEED. LONG FORM—KELLY CO 55 W NINTH SOUTH, S L C, UTAH

120

25008

BEGINNING 980 feet West of the Southeast Corner of the Southwest 1/4 of Section 4, Township 17 South, Range 4 West, Salt Lake Base & Meridian; thence North 1320 feet; thence West 1264 feet; thence South 625 feet; thence Southeasterly along the roadway 541 feet; thence South 470 feet; thence East 840 feet to beginning. More or less 35 Acres

BEGINNING 980 feet West of the Northeast Corner of the Northwest 1/4 of Section 9, Township 17 South, Range 4 West, Salt Lake Base & Meridian; thence South 1320 feet; thence West 840 feet; thence North 1320 feet; thence East 840 feet to beginning. More or less 25 Acres.

EXHIBIT 'A'

25008

The Southwest quarter of the Northeast quarter; of the Northwest quarter of the Southeast quarter; the Southeast quarter of the Northwest quarter; and the Northeast quarter of the Southwest quarter of Section 13, Township 18 South, Range 8 West, Salt Lake Base and Meridian.

EXCEPTIN THEREFROM that portion which lies within the boundaries of the DELTA CANAL COMPANY, MELVILLE IRRIGATION COMPANY, ABRAHAM IRRIGATION COMPANY and the DESERET IRRIGATION COMPANY distribution systems.

EXCEPTING THEREFROM all rights of way, stock trails, ditches and canals, gravel pits and gravel beds.

121

EXHIBIT 'B'

32

Loan No. .....

PROMISSORY NOTE

$ --56,000.00-- June 1, 19 78

FOR VALUE RECEIVED, the undersigned promise(s) to pay to Abco Insurance Agency, Inc.

or order, ----------Fifty-six thousand and no/100---------- DOLLARS, ($ --56,000.00-),

together with interest from date at the rate of eighteen per cent, (-18- %) per annum on the unpaid balance payable as follows, viz:

All accrued interest shall be paid on June 1, 1979; the entire balance of interest and principal shall be paid on or before June 1, 1980, provided, however, that no payment shall be permitted prior to June 1, 1979

in lawful money of the United States of America, negotiable and payable at the office of 410 Newhouse Building, Salt Lake City, Utah, 84111

without defalcation or discount. All payments hereinabove provided for shall be applied first on accrued interest and balance to reduction of principal. Any installments of principal and interest not paid when due shall, at the option of the legal holder hereof, bear interest thereafter at the rate of -10%- per annum until paid.

In case of default in the payment of any installment of principal or interest as herein stipulated, then it shall be optional with the legal holder of this note to declare the entire principal sum hereof due and payable; and proceedings may at once be instituted for the recovery of the same by law, with accrued interest and costs, including reasonable attorney's fees.

The makers and endorsers severally waive presentment, protest and demand; and waive notice of protest, demand and of dishonor and non-payment of this note, and expressly agree that this note, or any payment thereunder, may be extended from time to time without in any way effecting the liability of the makers and endorsers thereof.

This note and the interest thereon is secured by a first ~~xxxxxxx~~ Trust Deed dated June 1, 1978, covering real property in Millard County, Utah.

T. LaMar Dewsnup

Alethe Dewsnup

83

3

$ -33,000.00-- June 1, 19 78

FOR VALUE RECEIVED, the undersigned promise(s) to pay to Joseph L. ...ried, Trustee for the Annette Jacob Trust or order. ----------Thirty-three thousand and no/100---------- DOLLARS, ($ -33,000.00-), together with interest from date at the rate of eighteen per cent. (-18-%) per annum on the unpaid balance payable as follows, viz:

All accrued interest shall be paid on June 1, 1979; the entire balance of interest and principal shall be paid on or before June 1, 1980, provided, however, that no prepayment shall be permitted prior to June 1, 1979

in lawful money of the United States of America, negotiable and payable at the office of 410 Newhouse Building, Salt Lake City, Utah, 84111 without defalcation or discount. All payments hereinabove provided for shall be applied first on accrued interest and balance to reduction of principal. Any installments of principal and interest not paid when due shall, at the option of the legal holder hereof, bear interest thereafter at the rate of -10%- per annum until paid.

In case of default in the payment of any installment of principal or interest as herein stipulated, then it shall be optional with the legal holder of this note to declare the entire principal sum hereof due and payable; and proceedings may at once be instituted for the recovery of the same by law, with accrued interest and costs, including reasonable attorney's fees.

The makers and endorsers severally waive presentment, protest and demand; and waive notice of protest, demand and of dishonor and non-payment of this note, and expressly agree that this note, or any payment thereunder, may be extended from time to time without in any-way effecting the liability of the makers and endorsers thereof.

This note and the interest thereon is secured by a first ~~Mortgage~~ Trust Deed dated June 1, 1978, covering real property in Millard County, Utah.

T. LaMar Dewsnup

T. LaMar Dewsnup

Aletha Dewsnup

Aletha Dewsnup

FORM 812—MORTGAGE NOTE—KELLY CO., 33 W. NINTH SOUTH, S.L.C., UTAH

Exhibit "B"

34

4

...

...

...

ASSIGNMENT OF CONTRACT

THIS AGREEMENT by and between T. LAMAR and ALETHA DEWSNUP, hereinafter referred to as the assignors, and Trustees of UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT SHARING PLAN, ABCO INSURANCE AGENCY, INC. and JOSEPH L. HENRIOD, Trustee for the Annette Jacobs Trust, hereinafter referred to as the assignees.

WHEREAS, under date of November 26, 1976, ARROW INVESTMENT COMPANY, LIMITED, as sellers, entered into a Uniform Real Estate Contract with T. LAMAR DEWSNUP and ALETHA DEWSNUP, as buyers, which contract is delivered herewith, wherein and whereby the said sellers agreed to sell and the said buyers agreed to purchase, upon the terms, conditions, and provisions therein set forth, all that certain land, with the buildings and improvements thereon, erected, situate, lying and being in the County of Millard, State of Utah and more particularly described in Exhibit 'A' attached hereto.

WHEREAS, the assignees desire to acquire from the assignors all of the right, title and interest of the assignors in said property above described as evidenced by said written agreement.

NOW, THEREFORE, it is hereby mutually agreed as follows:

1. That the assignors in consideration of the Payment of Ten Dollars and other good and valuable consideration, the receipt of which is hereby acknowledged, assign to the assignees, all their right, title and interest in and to said above described property as evidenced by the aforesaid Uniform Real Estate Contract of November 26, 1976, concerning the above described property.

2. That to induce the assignees to pay the said sum of money and to accept the said contract, and the rights

obligation pursuant thereto the assignors hereby represent to the assignees as follows:

(a) That the assignors have duly performed all the conditions of said contract.

(b) That the contract is now in full force and effect and that the unpaid balance of said contract is $323,000, with interest paid to the 2nd day of January, 1978.

(c) That said contract is assignable.

3. This assignment is to secure three notes of the same date as follows:

$56,000 to Abco Insurance Agency, Inc.

$33,000 to Joseph L. Henriod, Trustee for the Annette Jacob Trust

$30,000 to United Precision Machine and Engineering Company Profit Sharing Trust

4. Assignors agree that in the event they are in default that assignees may make the payments due under and pursuant to said contract and will be reimbursed for the same by assignors.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and seals the first day of June, 1978.

/s/ T. LaMar Dewsnup
Assignor

/s/ Aletha Dewsnup
Assignor

/s/ Joseph L. Henriod
Attorney for Assignees
Assignee

STATE OF UTAH)
ss.
COUNTY OF SALT LAKE)

On the first day of June, 1978, personally appeared before me T. LAMAR and ALETHA DEWSNUP, the signers of the above instrument, who duly acknowledged to me that they executed the same.

/s/ Dixie K. Robinson
Notary Public
Residing at Salt Lake City, Utah

My commission expires:
5-9-79

IN THE SUPREME COURT
OF THE UNITED STATES

[Title Omitted in Printing]

Order Granting Petition for Writ of Certiorari entered 19 February 1991.

BEST AVAILABLE COPY

QUESTION PRESENTED

Respondents hold a claim against petitioner, a chapter 7 debtor, that has been fully allowed and that is secured by a lien on petitioner's property. The property has been abandoned by the trustee in bankruptcy. The question presented is whether petitioner is entitled under Section 506(d) of the Bankruptcy Code to reduce respondents' lien to the value of the property as determined by the bankruptcy court prior to any foreclosure sale.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-741

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF FOR THE RESPONDENTS

STATEMENT

Petitioner borrowed money from respondents and has not paid her debt. As security for the debt, respondents obtained a lien on certain farmland of petitioner's—a lien that, under Utah law and the security agreement, gave respondents a right to proceed against the property when petitioner defaulted. The court of appeals held that Section 506(d) of the Bankruptcy Code, 11 U.S.C. § 506(d), did not abrogate that state-law property right.

1. *Background.* On June 1, 1978, petitioner, together with her now-deceased husband, borrowed $119,000 from

respondents. The debt was secured by trust deeds on two farm parcels, neither of which was petitioner's principal residence. Respondents are the beneficiaries of the trust.[1]

The deed of trust states that, if the borrowers default on their obligations, respondents are entitled to declare the full amount due, to issue a notice of default, and (after an appropriate interval) to have the parcels sold at a public auction to the highest bidder, with the proceeds to satisfy the debt owed to respondents (as well as certain other expenses). Deed of Trust ¶¶ 14, 15. The deed is governed by Utah law. Utah statutes mirror the deed provisions granting respondents the right to proceed against the property to collect amounts owed on the loans. Utah Code Ann. §§ 57-1-20 to 57-1-37 (1990).

Petitioner defaulted in 1979.[2] Respondents exercised their rights under the deed of trust and, pursuant to Utah law, gave petitioner 90 days to cure the default, which petitioner failed to do. *See* Utah Code Ann. § 57-1-31. In a state court action, respondents then obtained a judgment confirming petitioner's remaining debt to respondents. J.A. 15.[3] Respondents thereupon gave notice of a non-judicial sale to enforce their lien.

---

[1] The deed of trust and promissory notes have been lodged by petitioner with the Clerk of the Court. (ABCO Insurance Agency, the only corporation among respondents, has no parent company and no subsidiaries except wholly owned subsidiaries. *See* Sup. Ct. R. 29.1.)

[2] For simplicity's sake, we hereafter refer only to petitioner, rather than jointly to petitioner and her late husband.

[3] Although petitioner repaid the original principal and interest on the $119,000 loan in late 1980, she remained indebted to respondents for approximately $50,000 in taxes and other expenditures that respondents were forced to make in order to protect their security on a third piece of property. The state court held that those expenditures were covered by the security agreement involving the two farm parcels at issue here. That ruling was not disturbed by the courts below and is not at issue in this case.

In April 1981, before the sale could take place, petitioner filed for bankruptcy protection, seeking reorganization under chapter 11 of the Bankruptcy Code. That filing stayed the property sale. 11 U.S.C. § 362. The 1981 petition was dismissed in 1982, and a second chapter 11 petition was dismissed with prejudice in 1984.[4] Petitioner thereupon filed the present liquidation petition under chapter 7 in June 1984. The successive petitions prevented respondents from exercising their rights under the deed of trust and completing any foreclosure sale.

2. *This Litigation.* After almost three years, petitioner filed a complaint in this chapter 7 case asking the bankruptcy court to divest respondents of their right to proceed against the property. J.A. 3-9. In particular, petitioner sought a declaration, first, that respondents' lien was valid only to the extent of the judicially determined value of the farm parcels and, second, that petitioner could redeem the parcels for that amount.[5] Petitioner argued that she was entitled to that relief under Section 506(d) of the Code, 11 U.S.C. § 506(d), even

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[4] *See* Findings of Fact, Conclusions of Law, and Order Regarding Dismissal of Case with Prejudice, *In re Lamar Dewsnup et al.*, Bankruptcy Case No. 82C-02046 (Bankr. D. Utah Feb. 16, 1984). The order, after reciting petitioner's repeated failure to propose a reorganization plan, precluded the filing of any further bankruptcy petitions under either chapter 11 or chapter 13. *Id.* at 9.

[5] As petitioner acknowledges (Pet. Br. 6), and as the opinions of the bankruptcy court and the court of appeals make clear, throughout this litigation petitioner has treated her lien-reduction claim as encompassing her claim for redemption of the property. *See* II R.O.A. 17-18 (trial brief of petitioner). Although she now pursues only her claim to lien reduction and has dropped her request for a declared right of redemption (*see* Pet. 12), in the court of appeals she treated the issues as inseparable, asserting that she sought the right to "avoid liens and effectively redeem real property." Br. of Appellant 5; *see also id.* at 4, 7.

though she had no such rights under Utah law. Pet. App. 3a, 16a-17a.[6]

Section 506(d) declares, with exceptions not applicable here: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." 11 U.S.C. § 506(d). Subsection (a) of Section 506 in turn states: "An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . ." 11 U.S.C. § 506(a). In petitioner's view, those provisions apply to respondents' lien and thus make the lien void over and above the judicially determined value of the property—the "allowed secured claim."

In June 1987, the bankruptcy court held a trial to determine the value of the farm parcels and found that they were worth $39,000. *See* Pet. App. 16a. The parcels were accordingly worth less than the lien, which, with interest on the outstanding debt, had a value of roughly $120,000 by mid-1988.[7] Because the estate could not receive any net benefit from liquidation of the property, in July 1988 the trustee abandoned "any interest that the estate may have in and to said property." J.A. 24. The trustee acted

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[6] Nothing in Utah law voided any part of the lien. Although Utah law would have allowed petitioner to buy the parcels within three months of the notice of default (Utah Code Ann. § 57-1-31), she failed to exercise that right. Utah law provides no right of redemption *after* a trustee's sale, though it does provide for redemption after a judicial mortgage-foreclosure sale. *Jones v. Johnson*, 761 P.2d 37 (Utah Ct. App. 1988); *see* Utah Code Ann. § 57-1-28(2) (no redemption right after trustee's sale), § 78-37-6 (mortgage foreclosure redemption right).

[7] Petitioner did not explicitly challenge the validity of her remaining debt. She argued, however, that all of her debt that was secured by the farmland had been satisfied. J.A. 4, 16. The bankruptcy court implicitly rejected even that contention. There is no doubt, therefore, that respondents' claim had been fully allowed under 11 U.S.C. § 502.

pursuant to 11 U.S.C. § 554(a), which authorizes abandonment of "any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate."

Meanwhile, in June 1988, the bankruptcy court issued its opinion on petitioner's request for a declaration that Section 506(d) rendered respondents' lien void in excess of $39,000. Pet. App. 16a-31a. Assuming in the opinion that the property either had been or was about to be abandoned by the trustee (*id.* at 17a n.1), the court held that Section 506(d) of the Code did not apply to the abandoned land, so that petitioner was entitled neither to redeem the property for $39,000 nor to receive any excess over $39,000 (less sale costs) that the land would bring at a (non-judicial or judicial) foreclosure sale. The court concluded that the property, having been abandoned and thus deprived of any further role in the administration of the estate, was no longer property of the estate and, therefore, the lien was not on "property in which the estate has an interest" under Section 506. Pet. App. 28a, 31a.

The court explained that any other interpretation would give petitioner more than she would receive outside bankruptcy. Petitioner's view would strip respondents of their right to force a sale (subject to any state-law redemption rights) and either buy the property themselves or collect the sale price (less sale expenses) up to the value of the outstanding secured debt. Pet. App. 30a. Petitioner's position would simply give her a windfall, for no purpose related to the function of Section 506: once completely abandoned, the farmland would play no part in "facilitat[ing] the administration and distribution of the bankruptcy estate." Pet. App. 29a; *id.* at 28a. The bankruptcy court dismissed petitioner's claim for relief under Section 506, leaving respondents with their state-law rights to proceed against the property. Pet. App. 14a-15a.

3. *The Court of Appeals' Decision.* The district court affirmed the bankruptcy court's dismissal of petitioner's complaint (Pet. App. 12a-13a), and the court of appeals affirmed (*id.* at 1a-11a). The Tenth Circuit, while relying heavily on the bankruptcy court's reasoning, also explained that petitioner's view of Section 506 was inconsistent with Section 722 of the Code. Pet. App. 9a-10a. In that provision, Congress expressly provided debtors a federal right to redeem certain abandoned property, but it limited the right to certain kinds of personal property, thus excluding petitioner's land. Yet allowing lien reduction under Section 506, the court of appeals reasoned, would—as petitioner has often acknowledged in this case (*see* note 5, *supra*)—effectively give the debtor the same right to redeem land that Congress excluded from Section 722. Pet. App. 10a.

Recognizing that the Third Circuit had recently adopted petitioner's view of Section 506 in *Gaglia v. First Fed. Sav. & Loan Ass'n*, 889 F.2d 1304 (1989), the court of appeals in the present case criticized *Gaglia* for failing to appreciate that its reading of Section 506 made the provision the functional equivalent of a federal redemption provision far broader than Section 722. Pet. App. 3a, 10a. The court also explained that, at bottom, the Third Circuit had relied on the erroneous view that use of Section 506 to strip down respondents' lien reproduced the result that would occur outside bankruptcy. In fact, the Tenth Circuit explained, a reversion of the property to pre-bankruptcy status—which is what occurs upon abandonment (Pet. App. 5a)—would not limit the lienholders' recovery to the judicially determined price; it would give the lienholders the right to purchase the property themselves or to have it sold to the highest bidder (subject to any state-law redemption rights), with the lienholders collecting the sale price up to the amount they are still owed. The Third Circuit's reading of Section 506 strips lienholders of some of this state-law entitlement,

even though the property plays no role in the bankruptcy. Pet. App. 7a-8a, 10a-11a.

INTRODUCTION AND SUMMARY OF ARGUMENT

Petitioner's reading of Section 506(d) treats that subsection as rigidly tied to subsection (a). In her view, once Section 506(a) has declared, for an allowed claim that is secured, how much of the claim is to be treated as secured and how much as unsecured for distribution purposes, Section 506(d) effects the same bifurcation of the lien on the secured property. Thus, petitioner proposes that Section 506(d) voids a lien whenever, and to the extent that, the lien exceeds the amount of the "allowed secured claim"—here, $39,000—that is set by Section 506(a). Pet. Br. 13-14.

Petitioner's reading of Section 506(d) has one, but only one, virtue: simplicity. That virtue, however, is not enough to sustain it as a proper conclusion about what Section 506(d) means. To the contrary, judged in light of pre-Code law and other provisions of the Code, petitioner's view simply could not have been what Congress intended.

Thus, pre-Code bankruptcy law preserved liens like respondents' lien, yet the Code's legislative history not only fails to reflect any intent to alter that longstanding practice but indicates a congressional intent to continue it. It has likewise been longstanding bankruptcy policy to avoid impairments of state-law property rights without a clear justification in bankruptcy functions. Here, the sole bankruptcy policy petitioner invokes—the "fresh start" policy—cannot justify impairing respondents' property rights as she urges: the fresh start contemplated by the Code does not extend to *in rem* claims against property but is limited to a discharge of *personal* liability, where, as here, the debtor has no protected interest in possession of the property. Moreover, petitioner's view of Section 506(d) would give her a re-

demption right even though Congress specifically denied her such a right when it addressed redemption in Section 722 of the Code. In addition, petitioner's view of Section 506(d) would give her the benefit of a voided lien even though Section 551 of the Code preserves liens for the benefit of the *estate*. Her view also would give her this benefit under chapter 7 even though she could not claim the same benefit under chapter 11, a result that would undermine the congressional preference for reorganizations over liquidations. Against this background, it is not surprising that, contrary to petitioner's argument, the text of Section 506(d) neither must nor should be read to reduce liens like respondents' to the judicially determined value of the collateral set by the court, prior to foreclosure, for purposes of Section 506(a).

First, as the court of appeals concluded, subsection (d) is inapplicable to a lien on property that is not the estate's property. It is clear, as an initial matter, that Section 506(d) cannot impair all liens on all property securing allowed secured claims against the debtor, for the Code does not impair liens on property of third parties, even if that property is pledged to secure a claim against the debtor. Petitioner herself therefore accepts the court of appeals' assumption that subsection (d) implicitly must be limited to "property in which the estate has an interest" (11 U.S.C. § 506(a)). *See* Pet. Br. 13-14, 25-28. What petitioner fails to recognize is that complete abandonment of the property, as occurred in this case, strips the estate of the required "interest" in the property, thus rendering Section 506(d) inapplicable.

This reading properly separates subsection (a) from subsection (d) by focusing on the relation of the collateral to the bankruptcy estate at different times and for different purposes. The lien-voiding subsection, since it is directed at lienholders' foreclosure powers, is addressed to the time at which such foreclosure is to take place: if the estate has abandoned any interest in the

collateral prior to that time, there is no basis in any bankruptcy function for thereafter invoking subsection (d) to give some of the lienholders' rights to the debtor. By contrast, subsection (a) performs the function of classifying claims in order to fix, for distribution purposes, the obligations of the estate to both secured and unsecured claimants; that provision is properly read as setting the amounts of the secured and unsecured portions of a claim while the estate still has its interest in the collateral, regardless of any later abandonment. So read, subsection (a) continues to furnish the "allowed secured claim" and "allowed unsecured claim" even for collateral that is abandoned and hence outside subsection (d).

Second, while the court of appeals' interpretation of Section 506(d) focuses on the nature of the collateral and its relation to the bankruptcy estate, a focus on the nature of respondents' *claim* reveals an additional reason why Section 506(d) need not, and should not, be read to produce the result petitioner urges. Thus, Section 506(d) may be read to void a lien only "[t]o the extent that" the claim it secures has not been allowed. Under this reading, subsection (d), in declaring a lien void "to the extent that [it] secures a claim against the debtor that is not an allowed secured claim," does not use "allowed secured claim" as if it were an indivisible phrase "defined" by subsection (a)—which, after all, is not by its terms a definitional section. Rather, the phrase in subsection (d) can and should be read term by term in its ordinary sense: the claim secured by the lien is an allowed secured claim under subsection (d), and the provision is for that reason inapplicable, if the claim is secured and the claim has been allowed, both of which are true in this case. A lien is void, under this permissible reading of the statutory language, precisely "[t]o the extent that" the claim it secures has been disallowed —here, not at all.

Third, if, contrary to our submission, the Court concludes that Section 506(d) applies here, the provision nevertheless should not be held to have the effect that petitioner suggests: that is, it should not be read as treating the judicially determined value of the collateral as placing a permanent ceiling on respondents' lien. Thus, if the Court concludes that Section 506(a) does *not* permanently establish the bifurcation of a claim in secured and unsecured portions prior to the collateral's abandonment, then the provision must be read as authorizing an adjustment of the judicially determined value of the collateral to reflect any higher value actually obtained at a foreclosure sale (whether from third parties or from the lienholders themselves). Absent a good reason not to effect such an adjustment, the foreclosure price is the most accurate, and fairest, value to use for deciding how much of a claim is secured and how much is unsecured. It follows, upon such an adjustment of the "allowed secured claim," that the surviving lien is adjusted to reflect the foreclosure price as well. Under this reading, as under the others, the 1987 judicial valuation does not place a permanent cap on respondents' *in rem* charge against the property.

Many of the structural, historical, and other arguments for why Section 506(d) does not authorize petitioner's proposed lien-stripping—why petitioner is not entitled to the windfall she seeks and respondents not obliged to accept the abrogation of their state-law property rights—apply equally to support all three of the reasons for rejecting petitioner's reading of Section 506(d). For simplicity's sake, however, we proceed in the main argument by setting out in full why this Court should adopt the court of appeals' reading of Section 506(d) as inapplicable to petitioner's property because it has been completely abandoned. The two additional reasons for rejecting petitioner's construction are then set forth briefly, in sections that incorporate the pertinent arguments articulated in full in defense of the court of appeals' reading.

ARGUMENT

SECTION 506(d) OF THE BANKRUPTCY CODE DOES NOT LIMIT RESPONDENTS' LIEN ON PETITIONER'S PROPERTY TO A VALUE DETERMINED BY THE COURT PRIOR TO A FORECLOSURE SALE.

The property of the debtor, petitioner here, has been judicially determined to have a value far less than the amount of the lien on that property held by the secured creditors, respondents here, whose claim against petitioner has been fully allowed. The property has been abandoned by the trustee and hence will play no role in this liquidation proceeding. The property will be sold at a foreclosure sale after the bankruptcy stay is lifted under Section 362 or the case is closed under Section 350. The question presented is whether the judicially assigned value of $39,000 (plus appropriate interest) places a ceiling on the secured creditors' interest in the property at the foreclosure sale, when the property is sold either to third parties or to respondents themselves (through bidding their claim at the sale).

Petitioner's position is that, once the court has valued the property, the lien is permanently stripped down to that value. For example, if a foreclosure sale were to bring $60,000, petitioner asserts a right to be written a check for $21,000 (minus appropriate interest and sale expenses), even though respondents still have not been paid a large part of the debt that is secured by that property.[8] Petitioner claims that Section 506(d) of the Bankruptcy Code achieves that result by depriving respondents of their full state-law right to payment of their debt out of the abandoned property. That view is incorrect: Con-

[8] Respondents have not received any distribution on the unsecured portion of their claim, and there is no indication that they will receive any such distribution, because, from all that has appeared throughout this extended liquidation proceeding, there are no assets to distribute in payment of unsecured claims in this case.

gress did not intend, in Section 506(d), to give petitioner the windfall she seeks or to abrogate respondents' state-law property rights.

I. The Court of Appeals Correctly Held Section 506(d) of the Bankruptcy Code Inapplicable to Respondents' Lien on Petitioner's Property Because the Property Has Been Abandoned by the Trustee.

Section 506(d) of the Bankruptcy Code declares: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void," unless no proof of claim was filed or the claim was disallowed under provisions dealing with unmatured support payments or rights of contribution. 11 U.S.C. § 506(d). Petitioner herself does not propose a literal reading of the provision. Thus, she accepts the court of appeals' assumption that, in order for Section 506(d) to apply to a lien, the lien must be, at a minimum, on "property in which the estate has an interest" (11 U.S.C. § 506(a)), a phrase that does not appear in subsection (d). *See* Pet. Br. 13-14, 25-28 (arguing that the scope of subsection (a) governs subsection (d) and that abandoned property *is* "property in which the estate has an interest").

It is plainly correct that Section 506(d) cannot have the effect—which would be its effect if read literally—of impairing liens on *all* property securing a secured claim against the debtor. If that were the case, Section 506(d) would impair, for example, liens running against *third parties'* property that has been pledged as additional security for a secured claim against the debtor. Under well-established law, however, distinct property interests that are not the *debtor*'s interests at all, and hence not the estate's property interests, are unprotected by bankruptcy law, including Section 506. "[I]f the debt is secured by property of a third party that property can be reached to the full extent of the security agreement."

R. Jordan & W. Warren, *Bankruptcy* 211-12 (2d ed. 1989).[9] That principle would be violated if Section 506(d) were read literally to apply to any lien securing an allowed secured claim against the debtor.[10]

Accepting that Section 506(d) thus cannot apply to all property securing a secured claim against the debtor, petitioner correctly follows the court of appeals' assumption that Section 506(d) is implicitly limited to "property in which the estate has an interest." Petitioner then errs, however, in believing that abandoned property falls within that phrase. In fact, as the court of appeals held, collateral like petitioner's, which has been completely abandoned by the trustee, is not property in which the estate has an interest and, like property held by third parties, therefore is not subject to the operation of Section 506(d). Pet. App. 6a.

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[9] Section 524(e) of the Code states that, with certain narrow exceptions, "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). Similarly, Section 362 stays foreclosure actions only against the *debtor*'s property, not against property of a third party. 11 U.S.C. § 362(a). And the Code's several provisions giving distinctive treatment to third parties who have secured the bankrupt's debt (*e.g.*, 11 U.S.C. §§ 502(e), 509, 506(d)(1)) all rest on the premise that the creditor's lien on a third party's property is unaffected by the bankruptcy—and so can be foreclosed on by the creditor while the bankruptcy proceeding is under way. *See* 3 L. King, *Collier on Bankruptcy* ¶ 502.05, at 502-83 to -93 (15th ed. 1991) [hereafter "*Collier* —— (15th ed.)"] Under pre-Code bankruptcy law, too, a creditor whose claim against the debtor was collateralized by property of a third party was not, by virtue of such collateral, a "secured creditor" within the meaning of the Bankruptcy Act. 11 U.S.C. § 1(28) (1976); 1 J. Moore, L. King, *et al.*, *Collier on Bankruptcy* ¶ 1.28, at 130.24 (14th ed. 1974).

[10] Thus, if a creditor had an allowed claim against the debtor that was secured both by a lien on the debtor's (*i.e.*, the estate's) property and by a lien on a third party's property, and if the "allowed secured claim" based on the debtor's (estate's) property were $39,000, then Section 506(d) would, read literally, void the lien on the third party's property, at least to the extent that the lien exceeded $39,000.

A. Petitioner's Property, Having Been Abandoned, Is Not "Property in Which the Estate Has an Interest."

1. Petitioner's attempt to apply Section 506 founders on the evident meaning of the phrase "property in which the estate has an interest." The phrase requires that the estate have, not merely some connection to, but a *property interest* in the collateral (*e.g.*, fee simple ownership, half-ownership, leasehold interest).[11] Any other interpretation would make nonsense of Section 506(a)'s use of the value of the "estate's interest" to refer to the collateral value (or, more precisely, the value of the estate's share of the collateral) to set the amount of the secured claim. 11 U.S.C. § 506(a) (quantifying the secured claim as "the value of [the] creditor's interest *in the estate's interest* in" the collateral (emphasis added)). This property interest of the estate, of course, is "property of the estate" under Section 541. 11 U.S.C. § 541(a).[12] Accordingly, "property in which the estate has an interest" must be "property of the estate" to the extent of the estate's interest in the property.

Abandoned property like petitioner's farmland, however, is to no extent property of the estate. H.R. Rep. No. 595, 95th Cong., 1st Sess. 343 (1977) ("[p]roperty ceases to be property of the estate . . . by . . . abandonment"); S. Rep. No. 989, 95th Cong., 2d Sess. 92 (1978) ("if property is neither abandoned nor administered it remains property of the estate"). It is well-recognized that "[a]bandonment is 'the release from the debtor's estate of property previously included in that estate.'" *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 508 (1986) (Rehnquist, J., dissenting) (quoting 2 W. Norton, *Bankruptcy Law and Practice* § 39.01 (1984)); 4 *Collier* ¶ 554.02, at 554-6 (15th ed.) ("[U]pon abandonment under section 554, . . . the property . . . is no longer part of the estate. Thus, abandonment constitutes a divestiture of all interests in property that were property of the estate."). An abandonment of the estate's property such as occurred here eliminates any property interest the estate has in the abandoned property and returns the property to its pre-bankruptcy status. *See Brown v. O'Keefe*, 300 U.S. 598, 602 (1937); Pet. App. 5a, 24a-26a (citing cases); H.R. Rep. No. 595, at 377; S. Rep. No. 989, at 92. Indeed, the trustee's notice of abandonment in this case made explicit the complete abandonment of *any* interest in the property: "the trustee hereby abandons any interest that the estate may have in and to said property." J.A. 24. The abandoned collateral here thus is not "property in which the estate has an interest."[13]

2. Apparently conceding that her position could not prevail if Section 506 used the phrase "property of the estate," petitioner suggests that the provision's use of the phrase "property in which the estate has an interest" compels a different result. Pet. Br. 26. She observes that, while early legislative versions of Section 506 used the phrase "property of the estate," the House Committee in

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[11] This is the natural use of the word "interest" in a bankruptcy context involving liens. Thus, in *Farrey v. Sanderfoot*, 59 U.S.L.W. 4483, 4484 (U.S. May 23, 1991), this Court read the phrase "interest of the debtor in property" in 11 U.S.C. § 522(f)(1) to refer to a "property interest."

[12] *Owen v. Owen*, 59 U.S.L.W. 4486, 4487 (U.S. May 23, 1991) ("An estate in bankruptcy consists of all the interests in property, legal and equitable, possessed by the debtor at the time of filing, as well as those interests recovered or recoverable through transfer and lien avoidance provisions.").

[13] Section 724(b) confirms this conclusion. That provision uses "property in which the estate has an interest" to refer to certain property that is to be "distributed." 11 U.S.C. § 724(b). The process of distribution, however, does not include abandoned property. *See, e.g.*, 11 U.S.C. § 725 (providing for disposition of property not "disposed of under another section"); S. Rep. No. 989, at 96 (abandonment provision, 11 U.S.C. § 554, is one such section).

1977 substituted the longer phrase that ultimately was enacted. Pet. Br. 26-27.[14] But petitioner does not and cannot point to any evidence in the legislative history suggesting that the alteration of the language was intended to produce what, in her view, was a significant change in the meaning of Section 506. *See American Hosp. Ass'n v. NLRB*, 111 S. Ct. 1539, 1544 (1991). And, in fact, there is a ready explanation for the substitution of phrases.

The enacted language takes explicit account of the common situation in which a creditor has a lien on a single piece of property that is not completely owned, in fee simple, by the debtor—a piece of land, for example, that is only half-owned by the debtor or in which the debtor has only a leasehold interest. In that circumstance, while the lien is on the land as a whole, only the debtor's interest in the property becomes property of the estate (11 U.S.C. § 541), and hence only that interest—the "estate's interest" in the property—serves to define the secured portion of the creditor's claim. For that situation, it was awkward and potentially confusing, though not perhaps technically inaccurate, for Section 506(a) to refer to the "lien on property of the estate" and to the value of the "property," since the lien was in fact on property that was not all property of the estate.

The language adopted by Congress more precisely and explicitly deals with this situation: it acknowledges the full range of property interests that the debtor, and hence the estate, could have in a piece of property securing a creditor's claim, even if less than the entirety of the collateral was "property of the estate." Section 506(a) thus refers to "a lien on property in which the estate has an interest" (the whole of the collateral) and declares that the claim is to be treated as secured only to the extent of the "estate's interest" in the property (that is, the debtor's interest in the collateral, now property of the estate). This change of language merely refined the earlier versions of Section 506: it made no substantive change in the scope of Section 506's coverage from what it would be if it used the term "property of the estate" —a phrase that, as petitioner seems to acknowledge, excludes abandoned property.[15]

[14] The House Committee's reported bill, H.R. 8200, § 506(a), 95th Cong., 1st Sess. (1977), substituted the ultimately enacted phrase for a provision of earlier bills that said: "An allowed claim of a creditor secured by a lien on property of the estate is a secured claim to the extent of the value of such creditor's interest in such property, and is an unsecured claim to the extent that such value is less than the amount of such allowed claim." H.R. 6 and H.R. 7330, § 506(a), 95th Cong., 1st Sess. (1977).

B. Petitioner's Proposed Impairment of Respondents' Property Rights in the Abandoned Collateral Would Not Serve the Basic Liquidation or Fresh Start Functions of Bankruptcy.

1. *The Code Disfavors Needless Impairment of State-Law Property Rights.*

Federal bankruptcy law has long embodied a commitment to respect state-law property entitlements, particularly the property rights of secured creditors, absent a clear expression of congressional intent to displace them. That commitment is evident in the Code's treatment of secured creditors generally, recognized recently by this Court: "Ordinarily, liens and other secured interests survive bankruptcy." *Farrey v. Sanderfoot*, 59 U.S.L.W. at

[15] That conclusion is supported by this Court's ruling on the significance of a comparable change made by Congress in Section 547(b) of the Code. In 1984, Congress changed the phrase "property of the debtor" in that provision to "an interest of the debtor in property." This Court, relying on the pertinent Senate Committee Report, recently made clear in *Begier v. IRS*, 110 S. Ct. 2258 (1990), that the two phrases are "coextensive." *Id.* at 2263 n.3. Not surprisingly, the very same Senate Committee Report also used the phrase "property of the debtor's estate" to refer to the "property in which the estate has an interest" that is covered by Section 506. S. Rep. No. 65, 98th Cong., 1st Sess. 5-6 (1983).

4484. Such interests are respected, to the fullest extent possible as *property* interests, through the guarantee of adequate protection (11 U.S.C. §§ 361-363): "what constitutes 'adequate protection' . . . is whatever gives the secured creditor the same value as the rights of repossession and sale would have given it." T. Jackson, *The Logic and Limits of Bankruptcy Law* 183 (1986).[16] As this Court explained in *Butner v. United States*, 440 U.S. 48, 56 (1979), "the federal bankruptcy court should take whatever steps are necessary to ensure that the [secured creditor] is afforded in federal bankruptcy court the same protection he would have under state law if no bankruptcy had ensued." [17]

The effect of voiding a lien like respondents' would be to strip them of some of their state-law property rights—their rights to foreclose on the property through judicial or nonjudicial forced sales. This Court has long recognized that such rights are property rights, protected by the takings clause of the Fifth Amendment. *See United*

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[16] A secured claim is "a claim to specific property, the creditor's collateral, rather than a claim to share in the distribution of the bankruptcy estate." R. Jordan & W. Warren, *supra*, at 211. Thus, secured creditors in a liquidation case are not placed in the distribution queue (11 U.S.C. §§ 507, 726), but are protected either through abandonment of the collateral and the lifting of the stay on foreclosure under Sections 554 and 362(d)(2), through the guarantee of adequate protection if the collateral is sold under Section 363, or through release of the collateral by the court under Section 725.

[17] The Court in *Butner* explained the general policy behind bankruptcy law's respect for state-law property rights, a policy that informs both the present Code and pre-Code law: "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a 'windfall merely by reason of the happenstance of bankruptcy.'" 440 U.S. at 54-55.

Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 370 (1988); *United States v. Security Indus. Bank*, 459 U.S. 70, 75 (1982). And the Court has indicated that disturbance of such rights, if nowhere mentioned in clear terms by Congress, is exceptional in bankruptcy law and not readily to be inferred. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 244 (1989); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 581-86 (1935).

As explained below (*see* pages 29-32, *infra*), the legislative history of Section 506 indicates that Congress did *not* intend to displace respondents' state-law rights. Nor has petitioner pointed to anything in the operation of the Code that requires the lien reduction sought by petitioner. And as we now explain, lien reduction serves neither of the two basic functions of this chapter 7 case—to liquidate and distribute petitioner's assets, and to give petitioner a fresh start. *See* Pet. Br. 15 (chapter 7 allows debtors to "liquidate their assets, distribute the proceeds to creditors, and obtain a discharge of pre-filing debts").

2. *Abandoned Property Like Petitioner's Plays No Role in the Liquidation Proceeding and Is of No Benefit to the Estate.*

Because the collateral in this case has been completely abandoned, it will play no role in the fulfillment of "the paramount purpose of bankruptcy liquidation"—"the reduction of the debtor's property to money as expeditiously as practicable so as to secure funds for distribution to general creditors." *Collier* ¶ 554.01, at 554-2 to -3 (15th ed.). Not being property of the estate, it is not covered by the trustee's principal duty to "reduce to money the property of the estate" (11 U.S.C. § 704(1)), and it is not subject to the trustee's powers to sell, lease, or use "property of the estate" under Section 363. 11 U.S.C. § 363(b), (c). The property will not be administered in the proceeding. Pet. App. 6a ("Abandoned property is *not* property administered by the estate.").

Such property likewise plays no role in maximizing the estate (and hence any distribution to general creditors) or in equitably allocating petitioner's assets among general creditors. The very reason for the uncontested abandonment of the land as "of inconsequential value and benefit to the estate" (11 U.S.C. § 554(a)) was that the estate, and hence general creditors, could not have any stake in the land: because respondents' lien was so much greater in value than the collateral, respondents clearly would be entitled to the full value of the property under the guarantee of adequate protection of the lien (11 U.S.C. § 363(f)), leaving nothing for other creditors.[18] By the same token, application of Section 506 to render respondents' lien partly void could not benefit the estate or general creditors: once the collateral is no longer property of the estate, it is the debtor, under petitioner's view, who must receive the benefit of any recovery from the property in excess of the judicially determined value (otherwise, she has no stake in the present dispute). *See* 11 U.S.C. § 551 (preserving voided liens for the benefit of the estate "but only with respect to property of the estate"). In short, petitioner's property, once completely abandoned, is simply irrelevant to the bankruptcy proceeding's functions of liquidating and distributing petitioner's assets.

3. *The Fresh Start Policy Does Not Support Lien Reduction.*

As petitioner observes, one of the purposes of a chapter 7 liquidation is "to enable debtors 'to get out from under the debilitating effects of too much debt . . . [and] obtain

[18] Indeed, given that petitioner "does not have an equity in such property"—"*i.e.*, the creditor is undersecured" (*Timbers of Inwood Forest*, 484 U.S. at 375)—and that the property "is not necessary to an effective reorganization" in this liquidation case, respondents would be entitled to a lifting of the stay of foreclosure under 11 U.S.C. § 362(d)(2). In this case, lifting of the stay has been postponed pending resolution of the question whether Section 506 affects the amount of respondents' lien.

a fresh start.'" Pet. Br. 17 (quoting H.R. Rep. No. 595, at 125). But the fresh start policy is not a free-floating bankruptcy rule: it is, instead, a policy that informs particular provisions of the Code. It is therefore significant that the policy is nowhere mentioned in the legislative history supporting Section 506 (H.R. Rep. No. 595, at 357; S. Rep. No. 989, at 68), even though it *is* specifically mentioned in the legislative history supporting various other provisions of the Code, such as Sections 362 (automatic stay), 522 (exemption), 525 (discrimination against bankrupts), 722 (redemption), and 727 (discharge). *See* H.R. Rep. No. 595, at 125-28, 340, 366, 384; S. Rep. No. 989, at 54-55, 81, 98. The congressional omission of any reference to that policy in the present context has a simple explanation: the policy does not apply. None of the policy's functions supports petitioner's claim for partial voiding of respondents' lien.

One function of the policy is to give a debtor the breathing space provided by the automatic stay under Section 362, but that function is plainly a temporary one and cannot support the permanent relief petitioner claims. Another function of the fresh start policy is to provide "adequate property for a return to normal life." H.R. Rep. No. 595, at 125. But, for chapter 7 cases, the Code specifically addresses that concern in the carefully crafted provisions governing exempt property (§ 522) and redemption (§ 722). Those provisions are narrowly limited to individual (non-corporate) debtors and to specified types and amounts of property that Congress, either itself or through deference to state decisions, deemed especially necessary to a person's "normal life." 11 U.S.C. §§ 522, 722. By contrast, petitioner's view of Section 506 would apply to all debtors in liquidation, including corporate businesses, allowing them to reduce their liens on all types of property, including commercial real estate like petitioner's farmland. To read Section 506 as accomplishing that result is simply to override the careful

limits Congress placed on the fresh start policy in the present setting.[19]

The discharge provision of chapter 7, of course, embodies the particular function of the fresh start policy on which petitioner relies (Pet. Br. 17-18): to relieve the debtor from "the pressure and discouragement of preexisting debt." *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934), *quoted in Grogan v. Garner*, 111 S. Ct. 654, 659 (1991); *see Louisville Bank*, 295 U.S. at 582. But that purpose cannot justify lien reduction under Section 506(d) for the simple reason that the lien is a charge only against the property, not a claim against the debtor. The debtor is discharged from any personal liability on the preexisting debt regardless of the remaining amount of the lien. *E.g.*, 11 U.S.C. § 727(b). And Congress deliberately limited the effect of the discharge to precluding any "personal liability" of the debtor (11 U.S.C.

[19] Petitioner herself acknowledges that chapter 7 of the Code is not generally designed to protect the debtor's possessory interests in property (because liquidation is the process of selling the property to pay creditors), while the reorganization and rehabilitation chapters are designed generally to protect the debtor's continued possession. Pet. Br. 15-16 (in chapters 11 and 13, but not chapter 7, debtor is to retain assets); *see In re Lindsey*, 823 F.2d 189, 191 (7th Cir. 1987); D. Epstein, J. Landers, & S. Nickles, *Debtors and Creditors* 710-12 (3d ed. 1987). In the chapter 11 and 13 setting, this aspect of the fresh start policy likewise does not support petitioner's view of Section 506(d): abandonment should not occur if the debtor's possessory interest in property is to be protected by the plan of reorganization or rehabilitation.

Even aside from abandonment, protection of the possessory interest in chapter 11 and 13 cases does not *require* Section 506(d)'s broad application to reduce liens securing allowed claims, if only because other provisions of the Code permit liens to be modified as needed to protect the debtor's possessory interests as part of the confirmed plans of reorganization or rehabilitation. *See* 11 U.S.C. §§ 1123(a) (permitting modification of liens), 1141 (property under plan generally free of creditors' claims, except as provided by plan), 1322 (permitting modification of secured creditors' rights), 1327(c) (property under plan is free of creditors' claims, except as provided by plan).

§ 524(a)), expressly indicating that no preclusion of *in rem* judgments against property was intended by this aspect of the fresh start policy. *See Johnson v. Home State Bank*, No. 90-693 (June 10, 1991), slip op. 4-6; *Collier* ¶ 506.07, at 506-71 to -72 (15th ed.); *see also* S. Rep. No. 989, at 76 ("The bankruptcy discharge does not prevent enforcement of valid liens."); H.R. Rep. No. 595, at 361 (same). Thus, the fresh start policy's goal of leaving the debtor without overhanging personal liability cannot support petitioner's reading of Section 506(d). *See Louisville Bank*, 295 U.S. at 594 (contrasting fresh start and lien avoidance).

Petitioner's view of Section 506(d) plainly would give her, not a "*fresh* start," but a "*head* start." *Lines v. Frederick*, 400 U.S. 18, 21 (1970) (Harlan, J., dissenting). Collateral might well bring more at a foreclosure sale than the judicial valuation—either because of an error in the judicial valuation[20] or because of appreciation (or anticipated appreciation) in the property.[21] Petitioner's position is that she is entitled to be handed a check for the amount over the judicially determined value. But that result would be nothing more than the awarding of a windfall benefit, a judicial grant to the debtor of cash representing equity in the property that she never had while her secured creditor remains unpaid. The fresh start policy does not support such a result.

[20] *See Collier* ¶ 506.04, at 506-26 (15th ed.) (because of "the inherent difficulty of determining the price that would be obtained in a hypothetical sale or other disposition of many, if not most, kinds of property that is not of a truly fungible nature, valuation should not be viewed as an exact science by any means"); S. Rep. No. 65, at 5-6 ("the courts have, in too many cases, undervalued collateral property to an extent which denies adequate protection to secured creditors").

[21] If the date of the bankruptcy petition is used as the valuation date (*see* note 32, *infra*), and the proceeding is lengthy, market fluctuations and other factors may substantially increase the value of the collateral prior to foreclosure.

C. Petitioner's Proposed Lien Reduction Under Section 506 Would Be Inconsistent with Section 722's Specific Limits on Redemption Rights.

Petitioner's reading of Section 506 would be "structurally inconsistent" (*Timbers of Inwood Forest*, 484 U.S. at 374) with Section 722: under her reading, petitioner "in effect achieves the same result" (*ibid.*) that Congress denied her in Section 722. Section 722 gives an "individual debtor" in a liquidation proceeding a right to

> redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

The provision, which marked "a very substantial change" from previous bankruptcy law (S. Rep. No. 989, at 95), is unusual in that it specifically addresses the rights of a debtor vis-a-vis a creditor with an allowed claim secured by a lien on property that is, because of exemption or abandonment, no longer of any interest to the estate or general creditors. The provision thus deals with precisely the same situation that is at issue in the present dispute over Section 506(d).

Section 722 is limited by its terms in a number of ways —to *individual* debtors with *consumer* debts secured by *tangible, personal* property intended for specific (*personal, family,* or *household*) uses. It is limited in those ways because Congress identified a problem peculiar to the specified circumstances: the covered consumer goods, once used, typically have an (ever-diminishing) market value much lower than their replacement value, so debtors are placed under great pressure by lienholders to enter into agreements reaffirming their full debts under 11 U.S.C. § 524(c) and (d); yet such agreements would give

the creditors an undue benefit over and above what they could receive upon repossession or foreclosure using the ordinary state-law processes. H.R. Rep. No. 595, at 380-81. Not seeing a comparable problem for other types of property, Congress restricted the right to redeem to the specified property, thus excluding real property like petitioner's.

Petitioner's view of Section 506 would both render Section 722 unnecessary for the consumer goods it does cover and effectively give any debtor, including those excluded from Section 722, a right to redeem any property, including property excluded from Section 722. Petitioner herself recognized the equivalence of lien reduction and redemption in the courts below. *See* note 5, *supra*. The reason is straightforward: if a lien on property is void over the judicially determined value (the amount of the "allowed secured claim"), any debtor who had the money to purchase the property for that amount under Section 722 could readily achieve the same result through the exercise of ordinary state-law rights.

Most readily, any debtor will be able to exercise the state-law right—apparently available in every jurisdiction—to buy any property, prior to any foreclosure, for the amount of the obligation that is secured by the collateral, now reduced by Section 506 to the "redemption" price.[22] Moreover, even if a foreclosure sale were to be

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[22] If Section 506(d) applies as petitioner suggests, "the debtor can redeem the property from secured creditors prior to foreclosure by paying an amount equal to the court's assessment of the collateral's value." Note, *An Individual Debtor's Right to Avoid Liens Under Section 506(d) of the Bankruptcy Code*, 12 Cardozo L. Rev. 263, 265 (1990); *id.* at 265 n.11 ("if a debtor owning overencumbered real or personal property defaults on a loan, uses section 506(d) to freeze the amount of the liens, and tenders payment of this reduced debt in full prior to foreclosure, then the secured creditor is required to accept payment and restore free and clear title to the debtor"); G. Osborne, G. Nelson, & D. Whitman, *Real Estate Finance Law* § 7.1 (1979) (preforeclosure "redemption" right available "in every juris-

held, a debtor who had the money to redeem the collateral could, as a practical matter, purchase the property at an immediate foreclosure sale: she could outbid any other bidder, without cost to herself, because any amount over the reduced lien value (excepting sale costs) is returned to her as the "owner" (trust grantor, mortgagor). *See, e.g.*, Utah Code Ann. § 57-1-29.[23] In either event, a debtor who was capable of exercising a Section 722 right could, by application of Section 506(d) alone, exercise the ordinarily available rights under state law and readily purchase the property just as if Section 722 applied.

If Section 506(d) reduced all debtors' liens on all property, therefore, there would have been no need for Section 722: the consumer-goods creditor would already have been stripped of the leverage to demand reaffirmation of the full lien. By the same token, if Congress had wished to enable debtors (including corporations) to purchase property other than that specified in Section 722 (including real property like petitioner's) for the amount of the "allowed secured claim," it surely would have so provided in Section 722, where it explicitly took the unusual step of adjusting rights solely between debtors and lienholders. Petitioner's view of Section 506 should be rejected because it would override the narrow limits on the special rights granted in Section 722.

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diction"); *id.* §§ 7.1-7.5 (discussing real property redemption law); U.C.C. § 9-506 (personal property redemption law).

[23] Thus, if the lien in this case were reduced to $39,000, and the sale were held immediately thereafter, petitioner could bid *any* amount over that sum—*e.g.*, if another bidder offered $60,000, she could bid $100,000—and still have a net cost of only $39,000 (plus sale costs): everything over that amount would be paid back to her. Even the sale costs should become insignificant once the debtor makes clear her intention and ability to pay the "redemption" price. In that situation, there should be few if any sale costs, both because no transfer of title to a new purchaser is required and because it will typically be pointless to hold a trustee's sale at all.

D. Applying Section 506 Here Would Be Counter to Pre-Code Bankruptcy Law and to the Legislative History.

In determining the intended meaning of Bankruptcy Code provisions, this Court has examined the state of pre-Code law for "interpretive assistance." *Ron Pair Enters.*, 489 U.S. at 244-45. The Court has explained that it "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure," especially where a change would produce an alteration of long-respected state-law property rights. *Pennsylvania Dep't of Public Welfare v. Davenport*, 110 S. Ct. 2126, 2133 (1990); *Ron Pair Enters.*, 489 U.S. at 244-45; *Midlantic Nat'l Bank*, 474 U.S. at 500-02; *Kelly v. Robinson*, 479 U.S. 36, 47-49 (1986). *See also Timbers of Inwood Forest*, 484 U.S. at 380; *Emil v. Hanley*, 318 U.S. 515, 521 (1943). That principle applies here. Pre-Code bankruptcy law did not reduce a secured creditor's lien on property that was not administered in the bankruptcy proceeding. Yet the language of Section 506 of the new Code does not command a different result (as discussed above), and there is no evidence in the legislative history to alter the pre-Code rule. Indeed, the legislative history strongly suggests that Congress intended to preserve the pre-Code practice—as this Court recently stated in *Johnson v. Home State Bank*, slip op. 4.

1. *Pre-Code Bankruptcy Law Preserved Liens Like Respondents'.*

Section 57(h) of the Bankruptcy Act of 1898, as amended (11 U.S.C. § 93(h) (1976)), "recognized the right of a secured creditor to pay itself from its security, and provided a means whereby and described the extent to which the secured creditor, if it chose to do so, could participate in distributions from the estate." *Collier* ¶ 506.02, at 506-3 (15th ed.). Thus, Section 57(h) permitted a secured creditor to participate in the distribu-

tion of the estate, but only after conversion into money or valuation of the collateral and "only on the unpaid balance." 11 U.S.C. § 93(h) (1976); *see Collier* ¶ 506.02, at 506-4 (15th ed). This so-called "bankruptcy rule" replaced the "equity rule," under which such a creditor could participate to the full extent of his claim. *See United States Nat'l Bank in Johnstown v. Chase Nat'l Bank*, 331 U.S. 28, 33-34 (1947); *American Sur. Co. v. Bethlehem Nat'l Bank*, 314 U.S. 314, 320 n.2 (1941) (Douglas, J., dissenting) (describing history of bankruptcy rule); *Merrill v. National Bank of Jacksonville*, 173 U.S. 131 (1899); *see* 11 U.S.C. § 597 (1976) (bankruptcy rule for reorganizations).

While limiting participation in the distribution from the estate, pre-1978 bankruptcy law did not reduce the secured creditor's *in rem* rights in the property: the statute said nothing to impair the validity or amount of the lien. "The 1898 Act contained no express provisions relating to . . . the effect of the bankruptcy case on the lien of a secured creditor." *Collier* ¶ 506.02, at 506-5 (15th ed.). And the clear practice under the Act was therefore to leave the lien itself unaffected. Derived from *Long v. Bullard*, 117 U.S. 617 (1886), the rule was summarized by this Court in *Louisville Bank*: "unless the mortgagee released his security, in order to prove in bankruptcy for the full amount of the debt, a mortgage even of exempt property was not disturbed by bankruptcy proceedings." 295 U.S. at 582-83 (citing *Long v. Bullard*). *See In re O'Gara Coal Co.*, 12 F.2d 426, 429 (7th Cir.), *cert. denied*, 271 U.S. 683 (1926) ("The provision and purpose of the law is that those having security shall, in the manner provided by the statute, get the benefit of that security, but must do so at the expense of reducing the claim upon which they are entitled to participate as a general creditor in the funds of the estate.").[24]

[24] This Court recently recognized the point even for exempt (that is, specially protected) property: "it was well settled . . . [in 1978] that valid liens obtained before bankruptcy could be enforced on

Accordingly, the judicially assigned value of collateral for an allowed claim under pre-Code law applicable to liquidations did *not* set a limit on the creditor's interest in the property itself, but left his full lien intact.[25] The effect of lien preservation was particularly significant where, as in the present case, the collateral was released from control of the bankruptcy court through abandonment, and foreclosure proceedings were pursued outside bankruptcy as permitted by state law: the creditor could collect up to the amount of the lien, as long as the underlying claim was not satisfied more than once and the creditor had not previously released the lien in order to claim a distribution from the estate as an unsecured creditor to the full extent of its claim. *See* 3 J. Moore, L. King, *et al.*, *Collier on Bankruptcy* ¶ 57.20, at 358-59 (14th ed. 1977). Pre-Code bankruptcy law thus recognized the special protection that creditors like respondents obtain by perfecting a security interest in property, and it treated the resulting charge against property as distinct from the personal claims against the debtor, leaving the *in rem* claims essentially undisturbed while discharging the debtor from the *in personam* claims.

2. *The Legislative History Shows that Congress Did Not Intend to Alter the Pre-Code Practice.*

Nothing in the legislative history refers to, or indicates that Congress intended to alter, the pre-Code preservation of liens like respondents'. Nor is there any indication that Congress intended to grant debtors like petitioner the benefit she claims—a limitation on the lien-

exempt property, see *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 582-583 (1935), including otherwise exempt homestead property, *Long v. Bullard*, 117 U.S. 617, 620-621 (1886)." *Farrey v. Sanderfoot*, 59 U.S.L.W. at 4484.

[25] Like the present Code (*e.g.*, 11 U.S.C. § 1123(a)(5)(E)), chapter X of the Bankruptcy Act separately *permitted* liens to be judicially modified, with appropriate protection of the lienholders' rights, by a plan of reorganization. 11 U.S.C. § 616(10) (1976).

holders' interest in the collateral to the judicially assigned value, thereby enabling the debtor to reap the benefit of any amount recovered at a foreclosure sale in excess of that amount, even if the lienholders have not been paid the debt that was secured by the property.[26] Such an absence of congressional statements supporting petitioner's reading of Section 506 is strong evidence that Congress did not intend the dramatic departure from longstanding prior law that petitioner claims.

The absence of legislative history supporting petitioner's claim to the benefit of lien reduction is particularly telling because Congress *did* specifically mention *other* benefits provided to debtors by Section 506. In describing the "new treatment of secured claims, especially the bifurcation of the claims into secured and unsecured claims," the House Committee observed that this treatment "has important protective consequences for both creditors and the debtor." H.R. Rep. No. 595, at 181. After describing the benefit to creditors (protection of the collateral value), the Committee stated: "For the debtor, the determination of the amount of the secured claim facilitates reorganization in the business context, and repayment plans in the consumer context, by defining the precise extent of the claims against the debtor that must be treated specially as secured claims." *Ibid.* (footnote, citing proposed §§ 1124, 1129, 1325(a)(5), omitted). The identified benefits to debtors are, first, focused only on Section 506(a) and, second, limited to cases under chapters 11 and 13. If Congress had intended that 506(d) would allow liquidating debtors to strip down a lien ad retain any proceeds over the judicially assigned value, that quite striking benefit would have been mentioned. *See also Collier* ¶ 506.01, at 506-2 to -3 (15th ed.) (discussion of other benefits, but not the benefit claimed by petitioner).

[26] As noted in Section II below, the only pertinent statements in the legislative history directly addressed to Section 506(d) strongly suggest that the provision voids a lien only to the extent that a claim has not been allowed. *See* page 43, *infra*.

In fact, the legislative history expressly undercuts petitioner's reading of Section 506(d): Committee statements describing 11 U.S.C. § 522, which governs exempt property, show that Congress affirmatively intended liens like respondents' to survive, as pre-Code law provided. *See Johnson v. Home State Bank*, slip op. 4 ("Codifying the rule of *Long v. Bullard*, 117 U.S. 617 (1886), the Code provides that a creditor's right to foreclose on the mortgage survives or passes through the bankruptcy."). Section 522(c) gives meaning to the "exempt" character of property by generally declaring that exempt property is not liable for any pre-petition debts of the debtor (including, of course, debts supporting allowed claims). 11 U.S.C. § 522(c). The provision then states exceptions, among them that such property *is* liable for debts secured by liens that are "not void under Section 506(d)" (if the liens are also not avoided under other provisions, such as Section 522(f)). 11 U.S.C. § 522(c). In explaining the provision, the House Committee Report states: "The bankruptcy discharge will not prevent enforcement of valid liens. The rule of *Long v. Bullard*, 117 U.S. 617 (1886), is accepted with respect to the enforcement of valid liens on nonexempt property as well as on exempt property. *Cf. Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 583 (1935)." H.R. Rep. No. 595, at 361 (footnote omitted). *See* S. Rep. No. 989, at 76 (identical language except for use of "does" in place of "will" in first sentence). That rule, as the cited page of *Louisville Bank* says, was that "unless the mortgagee released his security, in order to prove in bankruptcy for the full amount of the debt, a mortgage even of exempt property was not disturbed by bankruptcy proceedings." 295 U.S. at 582-83 (citing *Long v. Bullard*). Congress thus evinced its intent that Section 506(d) left in place the pre-Code practice of preserving liens.

That understanding clearly favors reading Section 506(d) to continue pre-Code practice, particularly as to abandoned property. For one thing, abandoned property is exactly like exempt property in that both are property

in which the estate no longer has, but once had, an interest: if that was the basis for the congressional understanding of Section 506(d)'s inapplicability to exempt property, the same understanding carries over to abandoned property. In fact, however, the congressional understanding extends more broadly—not only by virtue of the Committee Reports' reference to "nonexempt property as well as . . . exempt property," but also by necessary implication. If Congress intended to preserve liens on the special types of property that it singled out for exemption because of their importance to the debtor, it could not have intended Section 506(d) to void liens on other property, like commercial farmland, that is less personally important or necessary to the debtor.

E. Other Aspects of the Bankruptcy Code Undermine Petitioner's Claimed Entitlement to the Benefit of Lien Reduction in This Liquidation Case.

Petitioner's reading of Section 506(d) is further undermined by at least two additional aspects of the Bankruptcy Code—Section 551's preservation of voided liens for the benefit of the estate, not the debtor; and the congressional preference for reorganizations over liquidations.

1. *Section 551 Denies the Benefit of a Voided Lien to the Debtor.*

Section 551 of the Code undermines petitioner's reading of Section 506(d) as a matter of both congressional policy and statutory operation. Secton 551 declares, for property of the estate, that an avoided or stripped-down lien is preserved for the benefit of the estate. 11 U.S.C. § 551. The section thus operates to give to the general creditors, not the debtor, any recovery from such property at a foreclosure sale over the judicially determined amount but up to the lien value. Petitioner's view, by contrast, would give to the debtor—not to the general

creditors, and not to the secured creditor who has not been repaid—the benefit of the lien to the extent that it has been reduced. Yet if Congress in Section 551 clearly denied the debtor the benefit of a voided lien in preference to unpaid general creditors, Section 506(d) should not be read to grant debtors the same preference over unpaid secured creditors.

Indeed, the operation of Section 551 together with the abandonment provision, 11 U.S.C. § 554, leads directly to the court of appeals' reading of Section 506 as not voiding a lien on abandoned property. If the trustee has not abandoned the overencumbered collateral, then the portion of the lien voided by Section 506(d) is itself a property interest of the estate in the collateral under Section 551. When *that* interest is abandoned by the trustee, it revests in its prior owners, the secured creditors—just as the underlying collateral, upon abandonment, revests in its prior owner, the debtor. *See* Note, 12 Cardozo L. Rev. at 281 n.108 (citing H.R. Rep. No. 595, at 377; S. Rep. No. 989, at 92; *Brown v. O'Keefe*, 300 U.S. at 602-03). In two steps, then, the lienholders are returned to possession of their full lien. The same result should follow if the complete abandonment is accomplished in a single step—as here, by the trustee's abandonment of "any interest that the estate may have in and to said property." J.A. 24. In this situation, too, the lienholders should retain their full lien. *See* Note, 12 Cardozo L. Rev. at 282-83.

2. *Petitioner's Reading of Section 506(d) Would Undermine the Congressional Preference for Reorganization.*

Petitioner acknowledges that "Congress has expressed a preference for reorganization" over liquidation. Pet. Br. 20 n.11; *see, e.g.*, 11 U.S.C. § 706; *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 (1983). Yet her view of Section 506(d) would give debtors an incentive—in some cases, a very large incentive—to choose chapter 7 over chapter 11. That result would be especially

anamolous in light of Congress's reference to the benefits secured by Section 506 to chapter 11 debtors without mention of petitioner's claimed benefit for chapter 7 debtors. *See* page 30, *supra*.

In chapter 11, Congress gave creditors the right, even when collateral was not abandoned, to insist on full preservation of their liens on collateral, thus denying any stripping down under Section 506. 11 U.S.C. § 1111(b). Congress gave those rights to the chapter 11 creditor specifically so that the creditor, rather than the debtor, would benefit if the judicial valuation turned out to be too low or if the property appreciated in value in the future (the creditor could buy it at the foreclosure and resell it when the market rose). *In re Woodbridge N. Apts., Ltd.*, 71 Bankr. 189 (Bankr. N.D. Cal. 1987). Under petitioner's view of Section 506, however, debtors under chapter 7 would automatically gain that benefit by having their liens stripped down, thus giving debtors one incentive to choose liquidation over reorganization. In some cases, where the sole or major asset is a single piece of encumbered property that has taken a substantial fall in market value but is expected to rise in value as the market recovers, the incentive could be determinative of the choice between chapter 7 and chapter 11. Indeed, petitioner's view of Section 506 could provide a sufficient incentive for the debtor to file for bankruptcy in the first place, since a chapter 7 filing would enable the debtor to reduce her mortgage to the temporarily low market value.[27]

[27] For example, if farm property mortgaged for more than $100,000 and valued at that amount at the time of the mortgage later dropped in value to $40,000 (because, *e.g.*, of floods), a chapter 7 filing would, under petitioner's theory, allow the debtor to reduce the mortgage to $40,000, while a chapter 11 filing would not. That is essentially what occurred in this case. Indeed, petitioner in this case twice filed chapter 11 petitions that were dismissed after she was unable to propose a plan of reorganization; only then did she resort to chapter 7 in an attempt to strip down respondents' lien. *See* page 3, *supra*.

It is not responsive to say, as petitioner does (Pet. Br. 21-23), that Section 1111(b)(2) is an express exception to Section 506(d). The point is not that Section 506 contains any exception for chapter 7 cases but that, in determining the proper meaning of Section 506, the Court should consider whether the *result* produced by a proposed interpretation would undermine the congressional policy favoring reorganization. Petitioner's reading of Section 506 would undermine that policy.[28]

F. Section 506(a) Fixes the Portions of a Claim to Be Treated As Secured and Unsecured for Distribution Purposes Even Where the Collateral Is Eventually Abandoned and Is Therefore Outside Section 506(d).

Aside from the mistaken argument based on the fresh start policy, petitioner's principal argument against the court of appeals' reading is that Section 722's use of the phrase "allowed secured claim" in discussing "abandoned" property implies that such property is covered by Section 506(d). Pet. Br. 16 n.8, 26-27.[29] The argument is

[28] An analogous point might be made with respect to rehabilitation under chapter 13. The argument would depend, however, on the proposition that Section 1322(b)(2) overrides the otherwise-clear application of Section 506(d) to home mortgages. As petitioner notes, three courts of appeals have rejected that proposition, although the bankruptcy courts are divided on the issue. *See* Pet. Br. 19-20 & n.10. The issue need not be resolved in this case.

[29] Petitioner also suggests that the court of appeals' reading of Section 506(d) would render it superfluous (Pet. Br. 28), but that is not so. Under the court of appeals' reading, the provision is applicable where overencumbered (non-exempt) collateral has not been abandoned. That may well occur even in some chapter 7 cases: for example, if collateral (*e.g.*, supermarket equipment) must remain as an essential part of unencumbered property (the supermarket building) in order to maximize the return to the estate from the sale of assets (to obtain the value of a functioning supermarket), the trustee should not abandon the collateral because it is not "of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a). Section 506(d) will also apply in many, probably most, cases under chapters 11 and 13. As petitioner has noted, reorganization and

not that Section 722 refers to or requires the voiding of any lien under Section 506(d): Section 722 by itself "redeem[s]" the property "from [the] lien" without need for Section 506(d). 11 U.S.C. § 722; *see also Black's Law Dictionary* 1442 (4th ed. Rev. 1968) (to "redeem" is to "buy back" and to "liberate an estate or article from mortgage or pledge by paying the debt for which it stood as security"; it "implies the existence of a debt and means to rid property of that incumbrance"). Petitioner's argument, instead, is that the reference to "allowed secured claim" as setting the redemption price of abandoned property shows that Section 506(a) is applicable to such property and therefore that Section 506(d) is applicable.[30]

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rehabilitation proceedings are designed largely to protect the debtor's continued possession of property that is necessary for post-bankruptcy success. Pet. Br. 15-16. Such property should not be abandoned by the trustee as being "of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a).

[30] As a technical matter, Section 722's reference to Section 506(a) is explicable based on the unique nature of property covered by Section 722. The contingent redemption right granted by Section 722 would seem itself to be a property interest of the debtor that is property of the estate under Section 541 and remains so after the underlying collateral has been abandoned. If the debtor has asserted her intention to exercise her redemption right for certain consumer goods—she must do so within 30 days of filing her petition and then exercise the right within an additional 45 days, 11 U.S.C. § 521(2)—then abandonment by the trustee of the goods themselves should not include, or be construed as including, an abandonment of that redemption interest, a property interest, in the collateral. (The right to redeem the collateral immediately has a value equal to the value of the collateral.) Where, as here, Section 722 does not apply, however, there is no basis for avoiding the conclusion that the collateral has been completely abandoned, as the trustee said in his notice of abandonment (J.A. 24), and is therefore no longer property in which the estate has an interest.

We address in text the broader question of Section 506(a)'s setting of the secured and unsecured portions of a claim secured by collateral that is no longer "property in which the estate has an interest."

It is at this last step where petitioner goes wrong. Section 506 is *not* all of a piece: the fact that subsection (a) divides a claim into secured and unsecured portions where the collateral is abandoned does not imply that subsection (d) applies to such property. Rather, the statute is properly read so that subsection (a) continues to furnish the bifurcation of a secured claim into secured and unsecured amounts for distribution (and redemption) purposes, even while subsection (d) is inapplicable in adjusting the specific property rights of debtors vis-a-vis lienholders in collateral that is of no interest to the estate.

Subsections (a) and (d) apply differently because they address different problems. Subsection (a) is designed simply to assign a monetary value of the estate's obligations to creditors for distribution purposes. *See, e.g.*, 11 U.S.C. §§ 507, 726, 1129, 1325.[31] The eventual status of collateral outside bankruptcy is of no importance to the fixing of the amounts of the secured and unsecured obligations. For collateral that is eventually abandoned, therefore, Section 506(a) should be read as permanently fixing, while the collateral is property of the estate, the portions of the secured claim that will be treated as secured and unsecured.

This approach is authorized by Section 506(a)'s second sentence, directing that collateral be valued "in light of the purpose of the valuation and of the proposed disposition or use of such property." The distribution purpose of Section 506(a), as just explained, calls for a fixed pre-

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[31] Other provisions, such as 11 U.S.C. § 1129(b)(2), may alter the amount of distribution obligations for particular purposes or call for valuations independently of Section 506(a). As to the latter, for example, the guarantee of "adequate protection" of secured creditors does not and could not depend on Section 506(a). The pertinent Code provisions make no reference to Section 506(a) or to "allowed secured claims." 11 U.S.C. §§ 361-363. Those provisions must apply even when Section 506(a) is inapplicable because no proof of claim has been filed.

abandonment value. Indeed, if the valuation had to be kept up to date even after abandonment, a bankruptcy court would, in lengthy reorganization cases, be required to revalue collateral long after it had been abandoned. Such a requirement would hardly comport with abandonment's core function of ridding the bankruptcy proceeding of the duty to deal with the property.[32]

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[32] The Court need not decide whether the collateral value should be fixed for Section 506(a) purposes, either categorically or case by case, as of the date of the bankruptcy petition or as of some other pre-abandonment date. On the one hand, Section 502(b) fixes the amount of the allowed *claim* "as of the date of the filing of the petition" (11 U.S.C. § 502(b)), and *Timbers of Inwood Forest*, 484 U.S. at 372, suggests that the value of the collateral is fixed for Section 506(a) purposes from the petition date. Other provisions of the Code likewise treat the petition date as the "line of cleavage." *Everett v. Judson*, 228 U.S. 474, 479 (1913). *See, e.g.*, 11 U.S.C. §§ 522(a)(2), 522(b), 727(b). Pre-Code bankruptcy law treated the petition date as critical. *See In re O'Gara Coal Co.*, 12 F.2d at 430 (collateral value fixed as of time of petition). Moreover, a number of bankruptcy courts, including some that have supported petitioner's reading of Section 506(d), have used the petition date. *See, e.g., In re Donohue*, 110 Bankr. 41, 44 (Bankr. D. Kan. 1990); *In re Lindsey*, 64 Bankr. 19, 24 (Bankr. C.D. Ill. 1986); *In re Tanner*, 14 Bankr. 933 (Bankr. W.D. Pa. 1981); *see also In re Stoller's*, 93 Bankr. 628, 635 (Bankr. N.D. Ind. 1988) (value of collateral for purposes of 506(b)).

On the other hand, the Senate Committee Report and post-conference legislative statement, as well as the leading treatise, indicate that the valuation of collateral may change during the bankruptcy proceeding—although the cited examples involve valuations for purposes of different provisions (and only while property remains the estate's), not differing valuations for Section 506(a) purposes at different times (much less for abandoned property). S. Rep. No. 989, at 68; 124 Cong. Rec. S17411 (daily ed. Oct. 6, 1978); *Collier* ¶ 506.04, at 506-22 to -25, 506-37 to -39 (15th ed.). *Timbers of Inwood Forest* indicates that other Code provisions might use a different value from that set under Section 506(a): having suggested that the value of collateral is fixed under Section 506(a) standing alone (484 U.S. at 372), the Court said that the language of Section 1129(b)(2) gave secured creditors in chapter 11 the value of (non-abandoned) collateral as of the date of the reorganization plan. 484 U.S. at 377.

The proper valuation date should take into account any Code policies, which may differ from context to context, governing who should get the benefit of collateral's appreciation or bear the burden of depreciation. For example, Section 361 offers creditors adequate protection against depreciation from the petition date. *See Timbers of Inwood Forest*, 484 U.S. at 370. Section 551's preservation of voided liens for the estate might suggest that the estate should benefit from any appreciation in collateral value for non-abandoned property, while Section 552's specific protection of liens covering proceeds of collateral might suggest that the lienholder should benefit. At least one commentator has noted that the bankruptcy courts have used the petition date for valuation in cases that involve appreciating property. Carlson, *Undersecured Claims Under Bankruptcy Code Sections 506(a) and 1111(b): Second Looks at Judicial Valuations of Collateral*, 6 Bankr. Dev. J. 253, 254 n.2 (1989).

In contrast to subsection (a) of Section 506, subsection (d) is not concerned with the distribution process. It is addressed to the scope of a lienholder's continuing state-law property rights in the collateral itself. In this context, it is inappropriate to ask simply whether the collateral was *ever* property of the estate. Rather, a continuing interest of the estate in the collateral must exist in order to limit the lienholder's interests under Section 506(d). If, in order to protect the debtor's eventual possessory interest vis-a-vis the lienholder, the trustee has not abandoned the collateral—that is, the estate has retained its interest in the collateral—then Section 506(d) applies. If, on the other hand, the collateral has been abandoned because there is no continuing possessory interest of the debtor to protect against the lienholder's charges on the property, the collateral is not property in which the estate has an interest and is outside Section 506(d). The lienholder's property rights are thereby respected where, as in this case, no legitimate bankruptcy purpose would be served by disturbing them—even while Section 506(a) continues to serve its function in the distribution process.

II. Section 506(d) Does Not Apply to Respondents' Lien Because Their Claim Has Been Fully Allowed.

In addition to the fact that respondents' lien is not on the estate's property, there is a second reason—focusing not on the nature of the collateral, but on the nature of the claim—why Section 506(d) should be held not to apply to respondents' lien. Thus, Section 506(d) can, and should, be read as voiding a lien only to the extent that the claim it secures has not been allowed. Under this interpretation, while Section 506(a) bifurcates an allowed claim into secured and unsecured parts, Section 506(d) is not a bifurcating, or lien-*reducing*, provision at all for those claims, like respondents', that have been fully allowed.[33]

The language of Section 506(d) readily permits this reading. In the phrase "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim," the final three words need not be read, as petitioner reads them, as an indivisible term of art defined by Section 506(a). Subsection (a), in fact, is not by its terms a definitional provision; it merely sets the amounts of certain claims for distribution purposes and does not even use the three-word phrase "allowed secured claim." 11 U.S.C. § 506(a). Although that phrase, like "allowed unsecured claim," is used elsewhere in the distribution and plan-confirmation provisions of the Code to refer back to the amount that is established by Section 506(a) (*see, e.g.*, 11 U.S.C. §§ 507, 726, 1129, 1325), the three words in Section 506(d) simply need not be read to refer to that amount. Rather, the phrase can be read, term by term, to refer to any claim that is allowed and that is secured. Under this reading, Section 506(d) applies only to a lien that secures a claim—by definition, a

[33] The United States fully elaborates on this interpretation in its Brief as *Amicus Curiae*.

"secured" claim—that has not been allowed ("that is not an allowed secured claim").[34]

Section 506(d)'s use of the phrase "[t]o the extent that" reflects nothing more than the fact that a claim may be allowed only in part. Thus, Section 502(b) both expressly directs the bankruptcy court to determine the amount of a claim—including the "allowed claim . . . secured by a lien" (11 U.S.C. § 506(a))—and declares that the claim shall not be allowed "to the extent that" it falls into defined categories. 11 U.S.C. § 502(b). Section 506(d), then, declares that a lien is void to the extent that the claim has not been allowed. Of course, if the claim secured by the lien has been fully allowed, as in this case, then no part of the lien is void.[35]

This reading of Section 506(d) finds support, as an initial matter, in the exceptions to Section 506(d). The exceptions declare that certain liens are not void despite the fact that the claims they secure have been "disallowed" under certain subsections of Section 502 or have not been allowed for the simple reason that no proof of claim was filed. 11 U.S.C. § 506(d)(1) and (2). The exceptions thus underscore that the emphasis in Section 506(d) is on whether the claim has been allowed, rather than on what portion of the claim is treated as secured

[34] If the lien secures a claim, then the claim is by definition a secured claim. 11 U.S.C. § 101(37) (defining "lien" as a "charge against or interest in property to *secure* payment of a debt or performance of an obligation") (emphasis added). The term "secured" is nowhere defined in the Code.

[35] The placement of this lien-voidance provision as subsection (d) of Section 506 does not imply that it must follow the bifurcating role of Section 506(a). The provision naturally belongs in Section 506 because that is the section in which Congress addressed the relationship between allowed claims and secured status. The preservation of liens is but one aspect of that relationship. The proper treatment of a secured claim for distribution purposes is another, distinct aspect.

for distribution purposes. The second exception is particularly supportive. There is no good reason why Congress, having preserved a lien held by a creditor who successfully ignored the bankruptcy proceeding (as paragraph (d)(2) provides), should be understood to have stripped away property rights of a creditor who took the step of participating actively in the proceeding.[36]

This reading of Section 506(d) gives the provision the simple and sensible function (subject to the two stated exceptions) of voiding a lien whenever the claim secured by the lien has itself not been allowed. It thus ensures that the Bankruptcy Code's determination not to allow the underlying claim is given full effect by preventing assertion of a disallowed claim against the debtor's property as well as against the debtor personally. This is particularly significant where a portion of an otherwise-valid claim has been disallowed under Section 502(b) because of the type of claim it is; that is, where the claim is valid under state law (*e.g.*, a valid debt) but is not to be allowed in bankruptcy because, for example, it is a claim for unmatured interest or for certain property tax assessments or for unmatured alimony. *See* 11 U.S.C. § 502(b)(2), (4), (6).[37]

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[36] Section 501(c) permits a debtor or trustee to file a proof of claim on a creditor's behalf (11 U.S.C. § 501(c)), but the expressed purpose of that provision was not to give a lien-stripping right to the debtor. Rather, the aim of the provision, which is addressed to debts that are not dischargeable, was simply to reduce the debtor's post-bankruptcy debt by enabling the debtor or trustee to insist that such a non-dischargeable debt be partly paid through the bankruptcy distribution. S. Rep. No. 989, at 61.

[37] If the claim is disallowed because it is simply invalid on ordinary state-law grounds—*i.e.*, the debtor is not indebted or obliged to the claimant as alleged—then the lien itself would, to that extent, seemingly be invalid as well. *See* 11 U.S.C. § 101(37) ("lien" secures "payment of a debt or performance of an obligation"). In that circumstance, the lien would evidently be invalidated by the disallowance of the claim without need for Section 506(d). Of course, Section 506(d) makes that result explicit.

This interpretation not only comports with the statutory language, but is strongly supported by the legislative history. This reading preserves pre-Code bankruptcy law's rule permitting liens to pass through bankruptcy, a rule that the legislative history, far from suggesting any congressional intent to alter, affirmatively endorses. *See* pages 27-32, *supra*. Moreover, the particular legislative history of Section 506(d) strongly suggests the present reading of the provision. Both the Senate and House Committee Reports focus, in their descriptions of subsection (d), only on whether, and the extent to which, the claim secured by the lien has been allowed. Thus, the Senate Report's first sentence on subsection (d) says: "Subsection (d) provides that to the extent a secured claim is not allowed, its lien is void" unless certain exceptions apply. S. Rep. No. 989, at 68. The House Report states that if a party requests a determination whether a claim is to be allowed, "then the lien is void to the extent that the claim is not allowed." H.R. Rep. No. 595, at 357. Neither statement suggests any congressional intent that the lien be void to the extent that the claim is not treated for distribution purposes as a secured claim.

Reading Section 506(d) to preserve liens securing allowed claims is also reinforced by bankruptcy law's long-standing reluctance to disturb state-law rights in encumbered property and its treatment of such rights as largely distinct from the personal claims against the debtor that the bankruptcy proceeding discharges. *See* pages 17-19, 20-23, *supra*. In addition, the present interpretation respects the limits on Section 722's redemption right. *See* pages 24-26, *supra*. Nor is there even an issue raised by Section 722's reference to the "allowed secured claim," for that reference invokes only Section 506(a): if the claim has been fully allowed, Section 506(a) applies even though Section 506(d) is inapplicable. Finally, this reading of Section 506(d) both eliminates any improper incentive to choose liquidation over reorganization (*see*

pages 33-35, *supra*) and properly denies debtors like petitioner the windfall benefit she claims (*see* pages 23, 32-33, *supra*). For all of those reasons, the court of appeals' holding that Section 506(d) is inapplicable to respondents' lien is properly affirmed under this alternative rationale.

III. If Petitioner's Property Is Covered by Section 506(d), the Amount of the Surviving Lien Should Be Adjusted to Reflect Any Actual Recovery in a Foreclosure.

If, contrary to our submission, Section 506(d) applies notwithstanding the allowance of respondents' claim and the abandonment of the collateral, petitioner still should not reap the benefit of any recovery at a foreclosure sale over and above the value judicially assigned to the property in 1987. On these assumptions, Section 506(a) is properly read to require that the judicially determined value be adjusted to reflect the actual sale price (whether to a third party or to the lienholder), at least as long as there is no specific reason for not adjusting the value, such as substantial prejudice to the conduct or completion of the bankruptcy proceeding. Certainly, in this case, no such prejudice or other reason suggests that the court of appeals was wrong to deny petitioner's request that the judicially determined value of $39,000 be treated as a permanent cap on respondents' interest.

The second sentence of Section 506(a) directs the bankruptcy court to determine the value of collateral "in light of the purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506(a). Both the Senate Committee Report and the post-conference legislative statement expressly contemplate that the valuation may change during the course of the proceeding. S. Rep. No. 989, at 68; 124 Cong. Rec. S17411 (daily ed. Oct. 6, 1978). And the leading treatise states: "the statute makes reasonably clear that any valuation of collateral is temporal . . . . The courts have virtually uniformly recognized that the value of the property securing

a claim, and thus the allowed amount of the secured claim, may change during the course of a bankruptcy case." *Collier* ¶ 506.04, at 506-25 (15th ed.) (footnote omitted).[38]

If a foreclosure sale actually yields more for the property than the judicially determined value, whether in a sale to a third party or in a sale to the lienholder making a fair bid in anticipation of future appreciation, that is sufficient reason for a revision in the pre-foreclosure valuation and, hence, in the allowed secured claim—and, therefore, in the amount of the lien left unaffected by Section 506(d). Such an adjustment serves the general aim of valuation: to determine the market value of the collateral. *See Collier* ¶ 506.04, at 506-29 to -30 (15th ed.). It is consistent as well with the recommended practice of using the sale to determine the value in the first place: "If an actual disposition is to occur, regardless of the purpose of the valuation, the value of the collateral should be based on the consideration to be received by the estate in connection with the disposition, provided that the court determines such consideration is fair and was arrived at on an arm's-length basis." *Id.* at 506-27 (footnote omitted). And, of course, this approach serves three important bankruptcy goals: it prevents the debtor from recovering a windfall benefit; in the event of a higher foreclosure price, it gives the other general creditors a larger share of the estate (because the lienholder's unsecured claim is reduced); and it ensures that the lienholder does not suffer an abrogation of his full state-law property right.

To be sure, an adjustment of the amounts of the secured and unsecured claims might, in some cases, be so prejudicial to the orderly completion of the bankruptcy proceeding—particularly, to the distribution to creditors

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[38] Indeed, this general principle should require a new valuation of the collateral on any remand in this case in any event.

—that no adjustment should take place. Quite often, however, there should be no impediment to an adjustment. Most relevant here, the amount of the secured and unsecured claims may have no significance because there may be no distribution to unsecured creditors in any event (and the collateral has been abandoned in "payment" on the secured claim). In such a case, which is this case (*see* note 8, *supra*), altering the collateral value at *any* time should have no disruptive impact on the bankruptcy proceeding. Similarly, if there *is* to be a distribution to unsecured creditors, the adjustment should require nothing more than a subtraction from the previously determined unsecured claim of the lienholder and a corresponding addition to the pool available for distribution to the remaining general creditors. If no distribution has yet occurred, little prejudice should be caused. And even after a distribution, perhaps even after the case has been closed, there might be cases in which it is no substantial burden to adjust the Section 506(a) bifurcation of claims: the Code itself contemplates that cases may be reopened. 11 U.S.C. § 350. *See also* Bankr. Rule 5009.

In short, if the Court concludes that Section 506(d) applies to respondents' lien on petitioner's property, it nevertheless should affirm the court of appeals' holding that petitioner is not entitled, as she has claimed, to limit respondents' interest in the property at a foreclosure sale to the judicially assigned value of $39,000. No reason appears in this record why the collateral value should not be adjusted to reflect the result of a foreclosure sale. Any new argument that there is an impediment to the automatic adjustment of the lien to reflect that sale price should be made initially in the bankruptcy court.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

RICHARD G. TARANTO
(Counsel of Record)
H. BARTOW FARR, III
ALAN E. UNTEREINER
ONEK, KLEIN & FARR
2550 M Street, N.W.
Suite 350
Washington, DC 20037
(202) 775-0184
MICHAEL Z. HAYES
MAZURAN, VERHAAREN & HAYES
2180 South 1300 East
Suite 260
Salt Lake City, UT 84106
(801) 484-6161

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No. 90-741

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ALETHA DEWSNUP,

v. *Petitioner,*

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

REPLY BRIEF FOR THE PETITIONER

TIMOTHY B. DYK
(Counsel of Record)
PATRICIA A. DUNN
PATRICK J. POTTER
DEENA B. JENAB
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939
Counsel for Petitioner

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND AND FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

On Writ of Certiorari to the
United States Court of Appeals
for the Tenth Circuit

REPLY BRIEF FOR PETITIONER

ARGUMENT

Respondents concede that "Petitioner's reading of Section 506(d) has one . . . virtue: simplicity." Brief for the Respondents ("Resp. Br.") at 7. Correspondingly, the

inconsistent arguments offered by respondents and the government have one primary vice: a complexity that is wholly inconsistent with the plain and simple meaning of Section 506 of the Bankruptcy Code.[1]

In her opening brief petitioner urged that the court of appeals erred in holding that Section 506(d) is (1) not available to chapter 7 debtors, (2) not applicable to real property and (3) not applicable to abandoned property. Brief for the Petitioner ("Pet. Br.") at 9-11. Respondents apparently agree that the court's first ground is unsupportable, and make only a half-hearted attempt (*see* Part IV A. below) to support the second ground. The government does not support any of the three holdings, but seeks to support the court's result on an alternative ground not argued below. (*See* Part II below.) In taking these positions both respondents and the government seek to ignore the plain meaning of Section 506 and urge interpretations that require reading Section 506(d) in a vacuum, instead of as part of an entire section of the Bankruptcy Code designed to "govern[] the definition and treatment of secured claims." *United States v. Ron Pair Enterprises*, 489 U.S. 235, 238-39 (1989). In particular, both respondents and the government ignore the close relationship between Section 506(a), which limits secured

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1 Of course, statutory language must be accepted as conclusive "in the absence of a 'clearly expressed legislative intent to the contrary.'" *United States v. Turkett*, 452 U.S. 576, 580 (1981). *Accord Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S 102, 108 (1980); *Blum v. Stenson*, 465 U.S. 886, 896 (1984); *INS v. Cardoza-Fonseca*, 480 U.S. 421, 432 n.12 (1987); *United States Savings Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 379-80 (1988).

claims to the value of the property, and Section 506(d), which voids a lien to the extent that it "is not an allowed secured claim." 11 U.S.C. § 506(d) (1988). The respondents argue that while Section *506(a)* applies to abandoned property, Section *506(d)* does not. The government urges that while Section *506(a)* applies to allowed claims, Section *506(d)* does not. Neither respondents nor the government cite any authority for their novel suggestions that Section 506(d) should be treated as unrelated to Section 506(a); clearly Section 506(d) cannot be read in isolation.

I. CONTRARY TO RESPONDENTS' ARGUMENT, SECTION 506(d), LIKE SECTION 506(a), APPLIES TO ABANDONED PROPERTY

Respondents rely almost exclusively on the third of the court of appeals' grounds -- that Section 506(d) does not apply to abandoned property. They argue that Section 506(d) is unavailable to petitioner because the property had been, or was about to be, abandoned by the Chapter 7 trustee at the time of the Section 506(a) valuation hearing. Resp. Br. at 11-20.

Essential to an understanding of this argument is a description of Section 506. Section 506(a) is designed to deal with the situation, not uncommon in bankruptcy, where a lien exceeds the current value of the property. Before the 1978 Bankruptcy Code, lienholders under this Court's decision in *Long v. Bullard*, 117 U.S. 617 (1886), could continue to retain their liens after bankruptcy. The result was that the property remained impaired by liens far exceeding the property's value. In the 1978 Code, Congress adopted Section 506 of the Bankruptcy Code to

deal with this situation. It provided in subsection (a) that, when the secured claim exceeded the value of the property, the creditor would have a secured claim only "to the extent of the value of . . . [the property]" and an "unsecured claim to the extent that the value of [the property] is less than the amount of such allowed claim." 11 U.S.C. § 506(a). In subsection (d), Congress provided that the lien represented by the unsecured claim would be "void" and that, in addition, any lien represented by a disallowed claim would be "void." In subsections (b) and (c), Congress dealt with the situation in which "the value of [the property] *is greater* than the amount of" the lien and provided that interest and the expenses of "preserving or disposing of" such property could be recovered. 11 U.S.C. § 506(b) and (c) (emphasis supplied); *See United States v. Ron Pair Enterprises*, 489 U.S. at 238-39.

Respondents do not dispute, as shown in petitioner's opening brief (Pet. Br. at 25-27), that Section 506(a) applies to abandoned property.[2] However, respondents argue (1) that Section 506(d) must be limited to "property in which the estate has an interest" because 506(a) is so limited (Resp. Br. at 12-13); (2) that Section 506(a) applies to abandoned property and by implication the phrase "property in which the estate has an interest" must

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2 Indeed, as petitioner explained in her opening brief, "property in which the estate has an interest" in Section 506(a) must include abandoned property in order for Section 722 to operate. Pet. Br. at 25-27.

include abandoned property (Resp. Br. at 9, 37); (3) but that 506(d) does not apply to abandoned property because the phrase "property in which the estate has an interest" when read into Section 506(d) should be construed to have a different meaning in Section 506(d) than in Section 506(a) and to be the equivalent of "property of the estate" (Resp. Br. at 14); and (4) that "property of the estate" does not include abandoned property. *Id.*

It is not an overstatement to characterize respondents' argument as nonsensical. The same phrase "property in which the estate has a interest" cannot have different meanings in the two subsections of Section 506, particularly when the sole basis of implying such a limitation in Section 506(d) is because the phrase appears in Section 506(a). Respondents' concession that petitioner's estate does have an "interest" in her abandoned property under Section 506(a) means that Section 506(d) must be equally applicable to abandoned property.

As petitioner showed in her opening brief (Pet. Br. at 27-28), Section 506(d) would have little significance if it did not apply to abandoned property. Because "the trustee may abandon any property of the estate that is . . . of inconsequential value and benefit to the estate," the trustee will typically abandon property encumbered by liens exceeding the value of the property. 11 U.S.C. § 554 (1988). If Section 506(d) cannot be applied to abandoned property, it will certainly be deprived of one of its central

functions.[3] In summary, there is no basis for suggesting that Section 506(d) does not apply to abandoned property.[4]

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3 In any event, both respondents and the government concede that the property here had *not* been abandoned at the time of the valuation hearing. Resp. Br. at 4-5; Brief of the United States as Amicus Curiae Supporting Respondents ("Gov't. Br.") at 4 n.3. By arguing that the July, 1988 abandonment prevents the June, 1987 application of Section 506(d), respondents are suggesting that Section 506(d) is inapplicable before and after property is abandoned. Under respondents' interpretation, Section 506(d) would never be applicable to over-encumbered property because the bankruptcy court can always assume, as it did in this case, "that the real property has been or will be abandoned to the debtors." Petition for a Writ of Certiorari ("Pet. App.") at 17a n.1.

4 Respondents assert three additional arguments for their "abandonment" position, each of which petitioner addressed in her opening brief. First, respondents argue that stripping down unsecured liens on abandoned property would not serve the goals of chapter 7. Resp. Br. at 17-23. As shown at page 17 of her opening brief, Section 506(d) furthers the fresh start policy by assisting the debtor in retaining "adequate property for a return to normal life. . . ." H.R. Rep. No. 595, 100th Cong., 1st Sess., at 125, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6086 (hereinafter "H.R. Rep."). Contrary to respondents' argument (Resp. Br. at 22-23), providing the debtor with adequate property with which to begin life anew is a part of Congress's fresh start policy completely separate from discharging the debtor from personal liability. Second, respondents argue that petitioner's interpretation would undermine Congress's preference for re-organization. Resp. Br. at 33-35.

II. THE GOVERNMENT'S ALTERNATIVE ARGUMENT WAS NOT RAISED BELOW AND IS CONTRADICTED BY THE PLAIN LANGUAGE OF SECTION 506

In its *amicus curiae* brief, the government does not support the reasoning of the court of appeals, and does not support respondents' contention that the estate does not have an interest in abandoned property. Instead, the government raises as its principal contention a new argument in support of the result that the court of appeals reached, theorizing that Section 506(d) applies to void liens only on disallowed claims, that is, claims that are presented to and disallowed by the bankruptcy court. This argument should not be considered by this Court since it was not raised at any stage of the proceedings below. *See, e.g., Heckler v. Campbell,* 461 U.S. 458, 468 n.12 (1983). In any event, the argument is contrary to the plain language of the statute, its legislative history, the majority of lower court decisions and the leading commentators.

As shown by petitioner (Pet. Br. at 17-18), this is not the case. As noted in this Court's recent decision in *Toibb v. Radloff*, 111 S. Ct. 2197, 2201 (1991), "differences in the requirements and protection of each Chapter reflect Congress' appreciation that various approaches are necessary to address effectively the disparate situations of debtors seeking protection under the Code." Third, respondents argue that their position is supported by pre-Code bankruptcy law and the Code's legislative history. Resp. Br. at 27-32. The government and respondents rely on the identical legislative history (*see* Part II below), and that legislative history, despite respondents' suggestion to the contrary, unambiguously reflects that Section 506 was designed to change pre-Code law.

In apparent recognition of the weakness of the government's theory, even respondents do not appear wholly to adopt it, describing it as an "alternative rationale" in four pages at the end of their brief. Resp. Br. at 40-44.

A. The Government's Argument Is Inconsistent With The Language And Structure Of Section 506.

1. Section 506(d) simply does not state that it voids liens only on disallowed claims. Rather, Section 506(d) states that it voids liens "[t]o the extent that a lien secures a claim against the debtor *that is not an allowed secured claim* . . . ." 11 U.S.C. § 506(d) (emphasis supplied).

Section 506(d) follows plainly from, and expands upon, Section 506(a). Section 506(a) specifically states that "*[a]n allowed claim* of a creditor *secured by a lien* on property in which the estate has an interest . . . *is a secured claim* to the extent of the value of such creditor's interest . . ., *and is an unsecured claim* to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim . . . ." 11 U.S.C. § 506(a) (emphasis added). Because, as the government notes, it makes no sense for a lien to secure an unsecured claim (Gov't. Br. at 11), Section 506(a), by limiting the lien to the value of the property, must assume that the lien is being invalidated to the extent that the lien exceeds the value of the property.

Section 506(d) makes eminent sense in light of the objectives of Section 506(a). Section 506(d) formalizes

the result that Section 506(a) requires by explicitly voiding a lien relating to an allowed claim, "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim. . . ." 11 U.S.C. § 506(d). Section 506(d) also makes clear that, to the extent that a lien secures a claim that is disallowed, such lien is void. However, as the leading treatise on bankruptcy has noted, the view that only liens based on disallowed claims may be voided by Section 506 "is contrary to the express language of Section 506(d) . . . ." 3 L. King, *Collier on Bankruptcy* ¶ 506.07, at 506-74 (15th ed. 1990).

2. The fact that the other subsections of Section 506 apply to allowed claims provides further support that Section 506(d) is not limited to disallowed claims. *See* 11 U.S.C. § 506(a) ("[a]n allowed claim"), (b)-(c) ("an allowed secured claim"). As in *Ron Pair,* a party seeks here to limit a subsection of Section 506 where the language of that subsection plainly does not do so itself. Here, as in *Ron Pair*, Section 506 must be read as a whole.

3. If Congress had wanted to limit the application of Section 506(d) to disallowed claims, it knew how to do so. Where Congress wanted to specify a disallowed claim, it used, not surprisingly, the term "disallowed." *See, e.g.,* 11 U.S.C. §§ 502, 553(a), 1305 (1988). Congress did not use that phrase in the voiding provision of Section 506(d). Instead, Congress invested that subsection with broad application, choosing to void any lien to the extent that it secures a claim that is "not an allowed secured claim." 11 U.S.C. § 506(d). An *allowed unsecured claim* is plainly "not an allowed secured claim," just as a *disallowed claim* is plainly "not an allowed secured claim."

Again, *Ron Pair* is in point. In that case, the Court discussed whether Section 506(b), which uses the term "agreement," was restricted to consensual liens. The Court noted that, "[w]hen Congress wanted to restrict the application of a particular provision of the Code to such liens, it used the term 'security interest.'" *United States v. Ron Pair Enterprises,* 489 U.S. at 242 n. 5. The Court noted further that, "had Congress intended § 506(b) to apply only to consensual liens, it would have clarified its intent by using the specific phrase 'security interest,' which the Code employs to refer to liens created by agreement." *Id.* Here, as in *Ron Pair*, Congress's decision not to use narrow, well established Code terminology demonstrates that it had a broader purpose in mind.

B. The Legislative History And Prevailing Interpretation Of Section 506 Similarly Refute The Government's Argument.

The government reads the legislative history of Section 506(d) as it reads the language of Section 506(d) -- out of context. In doing so, the government distorts Congress's express understanding that Section 506 would constitute a major change from existing law.

1. Contrary to the government's selective reading, the legislative history of Section 506 as a whole confirms that section's plain meaning. In describing subsection (a), the House Committee Report states:

> [o]ne of the more significant changes from current law in proposed title 11 is the treatment of secured creditors and secured claims. Unlike current law, H.R. 8200 distinguishes between

> secured and unsecured claims . . . . The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors that are unsecured. . . . By addressing the problem in terms of claims, the bill makes clear that an unsecured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor.

H.R. Rep., at 180-81, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6141. Congress thus made clear that, in the 1978 Bankruptcy Code, it was making a "significant change" in "the treatment of secured creditors and secured claims" by limiting a "secured claim to the extent of the value of the collateral."

The government, understandably, ignores the history of Section 506(a), relegating it to a footnote in its brief, and describing the change in Section 506(a) as a "relatively procedural change." Gov't. Br. at 24 n.19. Instead, the government urges that the legislative history of Section 506(d) focuses on just one aspect, *i.e.*, that Section 506(d) operates to void liens on disallowed claims. Gov't. Br. at 23, citing H.R. Rep., at 357, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6313. That the legislative history of Section 506(d) does not mention its application to allowed unsecured claims is not surprising, however, in light of Section 506(d)'s largely formalistic role in voiding liens on allowed unsecured claims, liens that Section 506(a) has itself effectively eliminated. And, as noted by the Eleventh

Circuit, the legislative history of Section 506(d) "does not state on its face that a lien is voidable *only when* the claim is unallowable under Section 502." *Matter of Folendore*, 862 F.2d 1537, 1540 (11th Cir. 1990) (emphasis in original). As this Court similarly noted in *Ron Pair*, the 1978 Bankruptcy Code undertook "a substantial overhaul of the system," and, therefore, "it is not appropriate or realistic to expect Congress to have explained with particularity each step it took." *United States v. Ron Pair Enterprises*, 489 U.S. at 240 (internal citations omitted). Having described the "significant change" wrought by Section 506(a), it is hardly surprising that Congress did not separately describe the role of Section 506(d) in implementing this change.[5]

2. The government does not cite a single case in support of its view that Section 506(d) applies only to disallowed claims, an apparent concession that the courts have not adopted its interpretation. Indeed,

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5 The statement in the legislative history that "[s]ubsection (d) permits liens to pass through the bankruptcy case unaffected" is entirely consistent with petitioner's reading of Section 506. H.R. Rep., at 357, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6313. As the government points out, the historical practice is that a lien passes through bankruptcy unaffected to the extent that the Code does not invalidate it. *See* Gov't. Br. at 28 n.25, citing *City of Dallas v. Ryan (In re Brannon)*, 62 F.2d 959, 961 (5th Cir.), *cert. denied*, 289 U.S. 742 (1933). To the extent that Section 506 does not invalidate a lien, it continues to "pass through bankruptcy unaffected." *See also* H.R. Rep., at 361, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6317 (noting that a bankruptcy discharge "will not prevent enforcement of *valid* liens. The rule of *Long v. Bullard*, 117 U.S. 617 (1886), is accepted with respect to the enforcement of *valid* liens . . .") (emphasis added).

the Eleventh Circuit in *Matter of Folendore* flatly rejected the precise argument presented here. In that case, the Small Business Administration argued, as it does here through the Office of the Solicitor General, that Section 506(d) voids liens only on disallowed claims. The Eleventh Circuit disagreed, stating:

> The plain language of the statute, supported by the decisions of a majority of the bankruptcy courts, inferences drawn from the 1984 amendments, and common sense, requires the SBA's lien be voidable whether or not its claim has been disallowed under section 502. Consequently, we adopt the majority view that section 506(d) allows the voiding of a lien when a court has not disallowed the claim.

862 F.2d at 1539.[6] The leading treatise on bankruptcy has also noted that the view that Section 506(d) voids liens only on disallowed claims is contrary "to the rationale of the better-reasoned cases." 3 L. King, *Collier on Bankruptcy* ¶ 506.07, at 506-74 (citing over twenty cases). *See also* 1 W. Norton, *Norton Bankr. L. & Practice* § 28.27, at 222 (Supp. 1990) ("A majority of cases held that § 506(d) may be used by the debtor to void the unsecured portion of a claim divided under 506(a) or a junior judicial lien.") (citations omitted).

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6 As noted above, the Eleventh Circuit followed the majority view in holding that Section 506(d) is not limited to disallowed claims. 862 F.2d at 1539, citing *In re Garnett*, 88 Bankr. 123, 126 (Bankr. W.D. Ky. 1988); *In re O'Leary*, 75 Bankr. 881, 883 (Bankr. D. Or. 1987); *In re Worrell*, 67 Bankr. 16 (C.D. Ill. 1986); and *In re Tanner*, 14 Bankr. 933 (Bankr. W.D. Pa. 1981).

III. THERE IS NOTHING "UNFAIR" ABOUT INTERPRETING SECTION 506(d) ACCORDING TO ITS PLAIN LANGUAGE

By posing the following hypothetical, respondents suggest that applying the plain language of Section 506 would not produce the "fairest" (Resp. Br. at 10-12) result for creditors:

> Petitioner's position is that, once the court has valued the property, the lien is permanently stripped down to that value. For example, if a foreclosure sale were to bring $60,000 [on property valued at $39,000] petitioner asserts a right to be written a check for $21,000 (minus appropriate interest and sale expenses), even though respondents still have not been paid a large part of the debt that is secured by that property.

Resp. Br. at 11. This alleged dilemma, however, is nothing more than a red herring -- there is no unfairness.

First, "[n]o 'windfall' exists when debtors pay full and fair market value for the property they keep."[7] Respondents' hypothetical assumes that the court performing the Section 506(a) valuation will do so incorrectly.

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7 *See*, Howard, *Stripping Down Liens: Section 506(d) and the Theory of Bankruptcy*, (hereinafter "*Stripping Down Liens*") at 145-46 (Manuscript to be published in 65 Am. Bankr. L.J. (1991)(The manuscript has been lodged with the Court for the Court's convenience).

The assumption, however, should be that the court is making its best effort to accurately asses the value of the property. Indeed, in their Brief for Respondents in Opposition to the Petition for Certiorari ("Op. Cert."), respondents urged that "substantially inaccurate" valuations by the Bankruptcy Court did not "often" occur.[8]

Second, respondents concede that the secured creditor will have an opportunity to be heard on the valuation issue and, if dissatisfied with the result, can take an appeal. Op. Cert. at 9. At the same time, the secured creditor is always free to move, under Section 362(d), for relief from the automatic stay and, if granted, foreclose on the property. 11 U.S.C. § 362(d) (1988). Taking such a course of action should satisfy the creditor that it is receiving the fair market value for the property.[9]

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8 Respondents stated:

> [T]here is no pressing need to address the issue presented here. In any given case, what is at stake is the difference between the judicially determined value and the market value of the property (generally, what it would bring at a sale). *That difference will be large only if the court's determination is substantially inaccurate* or if the property has appreciated substantially since the filing of the bankruptcy petition (if that date is used for valuing the property). *That the difference is not often large is suggested by the failure of either party to take an appeal in virtually all of the cited bankruptcy-court decisions* . . . .

Op. Cert. at 8-9 (footnote and citation omitted) (emphasis supplied).

9 Apparently, respondents chose not to pursue vigorously their lift-stay remedies.

Third, if lienholders fail to pursue their objections and the abandoned property is sold, the result that respondents find objectionable is not unfair -- it is simply the result dictated by the Code. Here, respondents urged the trustee to abandon the property. Joint Appendix ("J.A.") at 23. The estate's interests could be abandoned "to any party with a *possessory interest* in the property abandoned,"[10] and the bankruptcy court found that they were abandoned to petitioner. Pet. App. at 17a n.1. Consequently, petitioner should receive any "excess" from a foreclosure sale. By arguing to the contrary, respondents are requesting that this Court unwind the abandonment. However, "[a]bandonment, once accomplished is irrevocable, regardless of any subsequent discovery that the property had greater value than previously believed." 4 L. King, *Collier on Bankruptcy*, ¶ 544.02, at 544-7 (15th ed. 1990). *See In re Bryson*, 53 Bankr. 3 (Bankr. M.D. Tenn. 1985). (Creditor, previously secured by cause of action that was abandoned, could not reopen the case and pursue debtor who subsequently recovered over $40,000 in such cause of action). Respondents cannot now recover interests that were abandoned by the estate simply because they may have increased in value.

Finally, it is actually respondents' construction that would encourage the type of unfairness that Section 506 was designed to eliminate. Pre-Code law was

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10 H.R. Rep., at 377, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6333; S. Rep. No. 989, 95th Cong., 2nd Sess., at 92, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 5878 (emphasis supplied) (hereinafter "S. Rep.").

"ambiguous and vague . . . on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor." H.R. Rep., at 181, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6141. "Secured creditors . . . exercised great leverage by virtue of the uncertainty . . . ." *Id.* at 6142. And, under pre-Code law, the debtor was "often required to err on the side of overprotection when formulating a reorganization or repayment plan." *Id.*

The effect of that leverage is readily apparent here. If respondents succeed, they could be free to assert a $120,000 lien against property worth only $39,000. At a foreclosure sale on the property, petitioner would be free to bid at the sale. However, by retaining the entire lien on the property, respondents could continue to outbid petitioner by bidding in "funny money,"[11] which exists because there is no cost to respondents in bidding the property up to the amount of the lien, there being typically no assets for the payment of unsecured claims. This ability to increase the bidding at no cost to respondents would allow them to pressure petitioner into paying a higher price for the property than its fair market value. Alternatively, respondents could use this leverage to coerce petitioner into reaffirming part or all of the prepetition obligations that she owes to respondents. Respondents' position would leave them free to engage in the very use of leverage that the statute was designed to prevent.

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11 "Funny money" is the term used to describe the sum of "money," above the fair market value of the property, available to the lienholder for increasing its bid at the foreclosure sale. *See Stripping Down Liens*, at 134.

IV. RESPONDENTS' OTHER ARGUMENTS ARE WITHOUT MERIT

A. Section 506(d) Applies To Real As Well As Personal Property.

In a brief discussion in their "abandonment" argument, respondents appear also to urge that Congress could not have intended that Section 506(d) would apply to real property because real property was not included in the type of property that could be redeemed under Section 722. As petitioner explained in her opening brief (Pet. Br. at 23-25), no such limitation appears in Section 506; respondents' argument is wholly inconsistent with the structure of the Code, and the leading bankruptcy treatise rejects this view as being "directly contrary to the clear language of section 506(d)." 3 L. King, *Collier on Bankruptcy*, ¶ 506.07, at 506-75.

Section 506(d) permits voiding of unsecured liens. *Matter of Folendore*, 862 F.2d at 1540; *see also Gaglia v. First Federal Sav. & Loan Ass'n*, 889 F.2d 1304, 1310 (3rd Cir. 1989). But with respect to "tangible personal property intended primarily for personal, family, or household use" (11 U.S.C. § 722 (1988)), Congress apparently believed that the voiding of the liens was insufficient because the state laws governing redemption of such personal property for bankrupts were too narrow (*see* S. Rep., at 95, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 5881), whereas the laws governing

redemption of real property were adequate.[12] For these reasons it is not surprising that redemption of personal property is treated separately from merely stripping down liens on all types of property.

B. Section 506(a) Does Not Provide For Multiple Valuations

Respondents argue that if Section 506(d) is applied to petitioner's property, then the amount of respondents' secured claim should be revalued in the event that more than $39,000 is paid for the property at a foreclosure sale. Resp. Br. at 44. As with the government's alternative argument, the Court should not consider respondents' argument because it was not raised in the briefs below. *See, e.g., Heckler v. Campbell*, 461 U.S. at 468 n.12.

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12 Debtors who pledge real property have greater redemption rights under state law than debtors who pledge personal property. For example, the debtor who pledges real property typically has 90 or more days to redeem the property upon default. *See, e.g.* Utah Code Ann. § 57-1-31 (1990). In contrast, state law, typically governed by Article 9 of the Uniform Commercial Code ("U.C.C."), severely restricts the debtor's redemption rights. *See* U.C.C. § 9-503 ("Unless otherwise agreed a secured party has *on default* the right to take possession of the collateral. . . . Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under Section 9-504."); *See* U.C.C. § 9-506. (the debtor cannot redeem personal property if, "the secured party has disposed of the collateral or entered into a contract for its disposition").

In any event, respondents' argument assumes that, after Section 506 is applied to void their unsecured lien, the property will be sold at foreclosure. However, petitioner intends to redeem the property for its fair market value, and there will be no foreclosure sale. Even assuming that the property were sold at foreclosure, there is no authority for respondents' novel argument. Section 506(a) provides for a single valuation -- not multiple revaluations whenever a creditor (or debtor) believes that the value has increased (or decreased). Revaluing property subject to Section 506 would introduce the very uncertainty that Congress sought to eliminate when it enacted that section.

CONCLUSION

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

TIMOTHY B. DYK
(Counsel of Record)
PATRICIA A. DUNN
PATRICK J. POTTER
DEENA B. JENAB
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005-2088
(202) 879-3939

Counsel for Petitioner

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In the Supreme Court of the United States

OCTOBER TERM, 1990

ALETHA DEWSNUP, PETITIONER

v.

LOUIS L. TIMM, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENTS

KENNETH W. STARR
Solicitor General

STUART M. GERSON
Assistant Attorney General

JOHN G. ROBERTS, JR.
Deputy Solicitor General

RONALD J. MANN
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

ALAN CHARLES RAUL
General Counsel
Department of Agriculture
Washington, D.C. 20250-1400

ERIC S. BENDERSON
Associate General Counsel for Litigation
Small Business Administration
409 Third Street SW
Washington, D.C. 20416

QUESTION PRESENTED

Section 506(d) of the Bankruptcy Code, 11 U.S.C. 506(d), provides in pertinent part: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." The question presented is whether this provision permits a debtor to "strip down" a lien to the value of the collateral, when that value is less than the claim secured by the lien, or instead whether the provision voids a lien securing a claim when the claim is not allowed.

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In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-741

ALETHA DEWSNUP, PETITIONER

v.

LOUIS L. TIMM, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENTS

INTEREST OF THE UNITED STATES

This case presents the question whether Section 506(d) of the Bankruptcy Code, 11 U.S.C. 506(d), enables a debtor to "strip down" a creditor's lien to the value of the collateral, when that value is less than the claim secured by the lien. This question is of great interest to the United States because its resolution will affect the level of security of any creditor holding an undersecured claim against a debtor that goes through bankruptcy, and because the federal government—whether through the Small Business Administration, the Farmers Home Administration, the Internal Revenue Service, or the Federal Deposit Insurance Corporation (as administrator of the properties of a number of failed depository institutions)—frequently holds such claims.

Because of the United States' broad perspective on this question, and because the United States takes a different view of the statute than either of the parties to the case, the United States is filing this brief to ensure that the broadest possible range of views informs this Court's evaluation of the question.

STATUTORY PROVISION INVOLVED

The text of 11 U.S.C. 506 is set out in the Appendix to this brief.

STATEMENT

1. On June 1, 1978, respondents loaned $119,000 to petitioner and her now-deceased husband. To secure their obligation to repay the loan, petitioner and her husband executed a deed of trust, granting a lien on two parcels of land they owned in Utah, as well as a collateral assignment of a contract to purchase some additional land. In 1979, petitioner defaulted under the terms of the deed of trust. Pursuant to the deed of trust and Utah law, respondents would have been entitled to accelerate the date of maturity of the loans (so that the entire amount immediately was due), to issue a notice of default, and eventually to sell the parcels at a public foreclosure sale to satisfy the debt and the expenses incurred in attempting to collect the debt. See J.A. 14, 37-39; Amended Trust Deed with Assignment of Rents, at 1 & ¶¶ 14-15; Utah Code Ann. §§ 57-1-20 to 57-1-37 (1990 & Supp. 1990).

2. In April 1981, after respondents had issued a notice of default but before the foreclosure sale occurred, petitioner filed a petition seeking reorganization under Chapter 11 of the Bankruptcy Code. That bankruptcy petition was dismissed in 1982, as was a second Chapter 11 petition that petitioner filed. Finally, in June 1984, petitioner filed a petition seeking liquidation under Chapter 7 of the Bankruptcy Code, out of which this case arises. Because of the pendency of these bankruptcy cases, respondents have not been able to conduct their foreclosure sale. J.A. 15-16.

3. In 1987, petitioner commenced this adversary proceeding, contending that because the debt then held by respondents of approximately $120,000 exceeded the fair market value of the collateral, the bankruptcy court should reduce or "strip down" the amount of the lien to the fair market value of the collateral. In particular, petitioner argued that, pursuant to Section 506(a), respondents would have an allowed secured claim only to the extent of the value of their collateral.[1] Petitioner then argued that Section 506(d)[2] required the court to void the lien on the remaining portion of respondents' claim, which Section 506(a) would treat as an allowed unsecured claim.

The bankruptcy court refused to grant relief. First, it valued the collateral at $39,000. The court assumed that the property had been abandoned, reasoning that petitioner, as the debtor, would not have standing to void the lien if the bankruptcy trustee still controlled the property.[3] Pet. App. 16a-17a. The bankruptcy court then rejected petitioner's request, concluding that once property is abandoned it no longer falls within the scope of Section 506(a), which applies only to "property in which the estate has an interest," and that it was "inconceivable * * * that Congress could have intended to create an avoiding power in a Chapter 7 debtor, respecting property which is not to be administered through the bank-

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[1] Section 506(a) provides, in pertinent part, that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest * * * is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property." The entire text of Section 506(a) is set out in the Appendix, *infra*.

[2] In pertinent part, Section 506(d) provides: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." The entire text of Section 506(d) is set out in the Appendix, *infra*.

[3] In fact, the property had not then been abandoned, but subsequently was abandoned on July 11, 1988. See J.A. 24.

ruptcy process." Pet. App. 29a. The district court summarily affirmed. *Id.* at 12a-13a.

4. The court of appeals also affirmed. The court relied on the effect of the abandonment, which required a determination by the trustee that the property "is burdensome to the estate or * * * of inconsequential value and benefit to the estate." Section 554(a); see Pet. App. 5a-6a. The court then determined that the "fundamental premise" of Section 506(a) was that it applies only when the estate has an interest in the property. Because "[t]he estate has no interest in, and does not administer, abandoned property," Section 506(a) should not apply. *Id.* at 6a. Finally, the court noted that a contrary result would be inconsistent with Section 722. In that section, Congress specifically granted debtors a limited right to redeem certain personal property. To hold that Section 506(d) granted a broader right to redeem real property, the court reasoned, would be inconsistent with the narrow language of Section 722. Pet. App. 9a-10a.

INTRODUCTION AND SUMMARY OF ARGUMENT

Chapter 5 of the Bankruptcy Code evaluates and sets priorities among the claims that creditors hold against bankrupt debtors. As a general matter, it analyzes claims pursuant to two criteria: whether they are allowable and whether they are secured. Because these criteria are not exclusive, they establish four types of claims: allowed secured claims, allowed unsecured claims, disallowed secured claims, and disallowed unsecured claims. The classification proceeds in two steps. First, Section 502 determines whether a claim is allowed or disallowed, generally by providing that the claim is allowed unless it falls within one of the exceptions set forth in the eight subparagraphs of Section 502(b), as modified by a number of miscellaneous rules set forth in Sections 502(c) through 502(j). If a claim is not allowed, the creditor will receive no distribution from the bankrupt's estate on that claim.

Second, Section 506 resolves a number of problems related to liens and allowed claims. Section 506(a) deals with allowed claims that exceed the value of the collateral given to secure repayment; it bifurcates those claims into an allowed secured claim, in the amount of the value of the collateral, and an allowed unsecured claim for the excess, so that the secured creditor can participate in any distributions to unsecured creditors to the extent of its unsecured claim. Sections 506(b) and 506(c) then deal with other situations not at issue here: allowed claims for less than the value of the collateral given to secure repayment, and treatment of administrative expenses related to the collateral.

This case concerns the effect of Section 506(d), which provides, with certain exceptions: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." We think the meaning of this provision is clear from the statutory text and structure, the legislative history, and pre-Code practice. If a creditor has a claim against the debtor secured by a lien, but that secured claim is not an *allowed* secured claim, then the creditor's lien is void. In other words, if a creditor has a claim secured by a lien and if the claim is not allowed—typically because it falls within one of the categories of disallowed claims in Section 502(b)—then the lien is also void. This makes sense, because it would be curious to have a claim disallowed but leave the lien securing that claim unaffected.

Petitioner reads the provision differently, contending that the key word is not "allowed," but "secured"—*i.e.*, the lien is void to the extent that it secures a claim that is not an allowed *secured* claim under Section 506(a). Under this reading, Section 506(d) would operate to reduce the creditor's lien to the value of the allowed secured claim described in Section 506(a). In our view, this reading makes no sense. It strains the statutory language, flies in the face of the statute's structure, and is flatly inconsistent with the legislative history and pre-Code practice.

The "lien-stripping" allowed under petitioner's reading would have a dramatic impact on the effect of a subsequent disposition of the property at a price greater than the bankruptcy court's valuation. If petitioner is correct, and the property is foreclosed upon after the bankruptcy and sells for an amount greater than the value attributed to the collateral by the bankruptcy court, the excess will go not to the unpaid creditor who bargained for a lien on the collateral, and not to other creditors who did not receive full payments of their debts in the bankruptcy, but to the debtor. By contrast, under our view, the debtor can retain the collateral only by repaying the entire debt or otherwise settling with the creditor who bargained for a lien on the collateral. The bankruptcy, of course, discharged the debtor from *in personam* liability, but it should have no effect on the *in rem* obligation represented by the lien. See *Johnson* v. *Home State Bank*, No. 90-693 (June 10, 1991), slip op. 3-4.

The text of the main portion of Section 506(d) distinguishes between secured claims that are allowed and those that are not allowed, not, as petitioner would have it, between allowed claims that are secured and those that are not secured. Similarly, the two exceptions to the general rule set forth in the main portion of Section 506(d) are both examples of disallowed claims, not unsecured claims. Petitioner's reading transforms the provision—which makes no specific reference to unsecured claims at all—into a major vehicle for invalidating liens based upon the secured or unsecured nature of the related claim under Section 506(a).

Petitioner's reading also divorces Section 506(d) from its integral role in the Code's treatment of disallowed claims. To effectuate the disallowance set forth in Section 502, the Code discharges the debtor from *in personam* liability in Section 727(b). The natural role of Section 506(d) is to complete this process by preventing the creditor from gaining any recovery *in rem* for disallowed claims.

The heavy weight that petitioner's reading places on Section 506(d) detracts from its focus on allowability and leads in several ways to anomalous results inconsistent with the structure of incentives throughout the rest of the Code. First, petitioner's reading of Section 506 as granting a broad and unlimited right to redeem any property sets at nought the specific right of redemption offered by Section 722. That section reflects Congress's considered and detailed policy judgment as to the circumstances under which debtors should be permitted to retain collateral without paying their debts. By allowing debtors a broader and less exacting right to redeem property under Section 506(d), petitioner would obviate the need for the right granted in Section 722.

Second, petitioner's interpretation of Section 506(d) gives debtors the right to put creditors in a worse situation than the specifically articulated provisions in Chapters 11 and 13. In those Chapters—where debtors are agreeing to use their future income to repay their creditors—Congress did specifically determine that it was appropriate to alter the rights of creditors in their collateral, and included provisions in the Code that make this unmistakably clear, while protecting the creditor against adverse treatment that does not further the policies of the Code. Petitioner's reading of Section 506(d) grants debtors the same benefits, but gives creditors none of the protections imposed by Chapters 11 and 13. Considering the evident congressional purpose to encourage debtors to reorganize and attempt to use their future income to pay their creditors—rather than liquidate and walk away from their debts—it is incongruous to suppose that the spare language of Section 506 offers debtors in liquidation proceedings a better deal than the highly reticulated provisions of Chapters 11 and 13.

The House and Senate Reports accompanying the bills that became the Code unambiguously reflect the focus on allowability set forth in the text of Section 506(d) itself, by describing the operation of the provision as

invalidating liens that secure claims disallowed in a bankruptcy proceeding. Indeed, the House Report seems to propose the exact opposite of petitioner's analysis, by describing the provision as one that allows "liens to pass through the bankruptcy case unaffected." Thus, nothing in the legislative history suggests the broad role petitioner envisions for Section 506(d); instead, at every step Congress explained the provision in a manner consistent with the reading we urge.

Finally, as this Court's cases repeatedly have recognized, Congress in enacting the Bankruptcy Code is unlikely to have rejected firmly established rules of pre-Code law without some clear indication of its intent. Pre-Code law recognized a general rule that liens passed through bankruptcy unaffected. Bankruptcy law contained no procedure that would allow a debtor in a liquidation proceeding to force a creditor to give up collateral on which it had received a lien, without paying the full amount of the debt. Moreover, as this Court has recognized, the legislative history of the Code demonstrates that Congress was well aware of this prior history and, indeed, believed that Section 506(d) carried these rules forward into the Code. This is not the sort of record that can support the assumption that Congress deprived creditors of rights so well-established.

In sum, petitioner's reading of Section 506(d) as a general authorization by Congress to strip down the liens of secured creditors with allowed claims cannot be squared with the text, structure, or policies of the Code, or with the history that led to its enactment. This Court should reject that reading and affirm the judgment of the Tenth Circuit.

ARGUMENT

I. CLOSE READING OF THE TEXT OF SECTION 506(d) SHOWS THAT ITS EFFECT IS LIMITED TO DISALLOWED SECURED CLAIMS

The precise language of Section 506(d) is the best guide to the meaning of the provision. See, *e.g.*, *Pennsylvania Dep't of Public Welfare* v. *Davenport*, 110 S. Ct. 2126, 2130 (1990) (applying to the Bankruptcy Code "the fundamental canon that statutory interpretation begins with the language of the statute itself"). The main body of the provision states simply: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." On its face, this appears to take one set of circumstances—where "a lien secures a claim"—and carve out of it a lesser and included set of circumstances—where that secured claim "is not an *allowed* secured claim." Liens in the carved-out set are void. Because both sets of circumstances are defined by reference to a "claim" that is "secured," and because the qualifying additional fact associated with the carved-out set of circumstances is that the secured claim is "not * * * allowed," the most natural understanding of the provision is that it operates to void liens on claims that are secured, but not allowed.

Petitioner reads this provision as turning not on whether the secured claim is allowed or not alowed, but on whether an allowed claim is secured or unsecured. According to petitioner, what the provision means is that a lien securing an unsecured claim is void. But the provision is triggered only "[t]o the extent that a lien secures a claim," and if a lien secures a claim the claim is not, at least in common parlance, unsecured. It is true that under certain circumstances Section 506(a) divides allowed claims secured by liens into secured claims and unsecured claims for purposes of distributions in the bankruptcy proceeding. But if, as petitioner supposes, the purpose of Section 506(d) was to deal with liens se-

curing these *unsecured* claims, it is implausible that Congress would have signalled such an intent with a general reference to circumstances in which "a lien secures a claim," rather than by a specific reference to Section 506(a) or to unsecured claims. Moreover, it is inconsistent to say—as petitioner urges—that the prime situation at which the provision is directed is one where, because the collateral is worth less than the amount of the claim, the lien in fact *fails* to secure the claim. Under petitioner's reading, a provision that applies "[t]o the extent that a lien secures a claim" actually applies *only* to the extent that the lien does *not* secure the claim. This reading is unnatural at best.[4]

That Section 506(d) turns on allowability is confirmed by the nature of the two exceptions to the body of Section 506(d). If Section 506(d) was concerned with the treatment of liens on unsecured claims, the exceptions presumably would address situations in which the unsecured status of a claim nevertheless did not trigger the general rule. By their terms, however, both of the exceptions are for disallowed claims. The first exception, Section 506(d)(1), protects liens that secure claims disallowed under Sections 502(b)(5) and 502(e). The second exception, Section 506(d)(2), protects the liens of secured creditors who fail to obtain allowed secured claim status solely because they fail to file a proof of claim under Section 501. Pursuant to Section 502(a), a claim is not allowed unless a proof of claim is filed; thus, absent Section 506(d)(2), liens securing payment of these claims would be voided by the main body of Section 506.

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[4] The text argues that the reference in Section 506(d) to claims that are not allowed secured claims was aimed at disallowed secured claims rather than at claims that become allowed unsecured claims by operation of Section 506(a). We note that, under any reading of the statute, we need not address the fourth type of claim, a disallowed unsecured claim, because it is not possible for Section 506(a) to produce a disallowed unsecured claim; Section 506(a), by its terms, applies only to "[a]n allowed claim."

In our view, it is more than a coincidence that there are no references to allowed unsecured claims in the exceptions to Section 506(d); the most likely explanation is that allowed unsecured claims do not fall within the body of Section 506(d) in the first place.

II. THE STRUCTURE OF THE CODE SHOWS THAT SECTION 506(d) CAN APPLY ONLY TO DISALLOWED CLAIMS

A. Section 506 Plays an Integral Role in the Code's Treatment of Disallowed Claims

A broader look at the structure of the Code confirms the integral role of Section 506(d) in the disposition of disallowed claims, a role that is completely unrelated to the status of the claims as secured or unsecured. See, *e.g.*, *Grogan* v. *Garner*, 111 S. Ct. 654, 659 n.13 (1991) (applying to Bankruptcy Code the teaching that "[i]n determining the meaning of the statute, we look not only to the particular statutory language but to the design of the statute as a whole and to its object and policy") (quotation omitted). As we mentioned above, Section 502 of the Code sets forth several categories of claims and subjects them to adverse treatment by excluding them from the group of claims that are allowed. For example, Section 502(b)(1) disallows claims that are unenforceable under state law, Section 502(b)(4) disallows claims for fees payable to attorneys or other insiders that exceed the reasonable value of the services, and Sections 502(b)(6) and 502(b)(7) disallow excessive claims for compensation for termination of a lease or employment contract.

In the bankruptcy proceeding itself, the holder of a disallowed claim receives no distribution for that claim.[5] Two provisions address the post-bankruptcy consequences of disallowed status. First, Section 727(b) grants eligible debtors a discharge "from all debts" that arose be-

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[5] See Sections 726(a); 1124(3)(A), 1325(a)(4) and (5).

fore the bankruptcy, "whether or not a claim based on any such debt * * * is allowed under section 502"; this protects the debtor from any subsequent *in personam* liability on disallowed claims.[6] Second, Section 506(d) deals with *in rem* liability, voiding liens that secure payment of the disallowed claims, ensuring that the disfavored creditor does not retain any avenue from which it might seek payment. In the absence of Section 506(d), a creditor holding a pre-bankruptcy judgment lien securing a disallowed claim could proceed after the bankruptcy to satisfy its claim out of any remaining property of the debtor, even if the property has been protected from creditors under the Code.[7]

In sum, the structure of the Code demonstrates a clear need and coherent purpose for Section 506(d), which—contrary to petitioner's submission—has nothing to do with allowed unsecured claims. Every definitive use of the provision points, like its language, to a focus on disallowed status rather than on unsecured status.

B. Application of Section 506(d) to Unsecured Claims Leads to Incongruous Results Inconsistent with Other Provisions of the Code

The best confirmation of the accuracy of the natural reading of the text described above comes from considera-

[6] Compare Section 1141(d)(1)(A)(ii) (similar treatment in Chapter 11 discharge); Section 1328 (similar treatment in Chapter 13 discharge).

[7] The coherence of this structure of provisions to effectuate the purposes of Section 502 is illuminated by the analogous provisions the drafters used to grant special treatment to unmatured alimony and child-support obligations. Section 502(b)(5) disallows these claims to the extent that they are unmatured; accordingly, pursuant to Sections 507 and 726, these obligations are not liquidated and prepaid in the bankruptcy. On the other hand, Section 523(a)(5) protects them from the normal discharge rules of Section 724(b), and Section 506(d)(1) protects liens that secure these claims from invalidation under Section 506(d), regardless of the value of the collateral or the amount of the allowed secured claim, as determined under Section 506(a).

tion of the bizarre results of petitioner's reading, which cannot be squared with the specific rights granted debtors in Section 722 or the detailed creditor-protective provisions set forth in Chapters 11 and 13.

1. Congress recognized the harsh straits debtors would face under a firm rule that did not allow debtors to alter any of the rights of secured creditors. Accordingly, in Section 722 it granted debtors a right in certain limited circumstances to redeem personal property by paying the creditor the value of the collateral, even if the value paid is less than the debt.[8] The rights granted to the debtor are limited carefully; they apply only to "tangible personal property intended primarily for personal, family, or household use."[9] Also, the debtor cannot leave its creditor in suspense during a long bankruptcy proceeding, because Section 521(2)(A) requires the debtor to notify the court within 30 days of the filing if it intends to redeem the collateral, and Section 521(2)(B) requires the debtor to complete the redemption within 45 days thereafter.

Under petitioner's reading Section 722, with its specific and limiting restrictions, is wholly superfluous, because a debtor, at any time or from time to time, and without regard to the nature of the collateral, could come to the

[8] The history of this provision is particularly damaging to petitioner's reading, because it demonstrates that Congress well understood that, in the absence of Section 722, the normal provisions of bankruptcy law would require the debtor to pay the entire amount of the debt if he wished to retain the collateral, even if the debt exceeded the value of the collateral. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 128 (1977) ("[I]t does little good to allow the debtor an exemption of wearing apparel, household goods, or health aids subject to an indefeasible security interest * * * if the debtor must pay more than the property is worth for the privilege of continuing to use the property.").

[9] The legislative history shows that the limitation to certain goods was intentional, so that the right would apply only to property necessary for the debtor to make a fresh start. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 127-128 (1977).

court under Section 506(d) and have the court strip down a lien to the value of the collateral. Moreover, although Section 722 alters the creditor's rights only if the debtor tenders full payment within 45 days, petitioner's reading of Section 506(d) would reduce the value of the lien immediately, and leave the debtor an option—to be exercised at any time before foreclosure—to tender to the creditor the amount of the lien and thus retain the collateral free and clear.[10] This effectively grants the debtor an opportunity to speculate as to market changes in the value of the collateral that is utterly inconsistent with the rigorous deadlines set forth in Section 521. Moreover, if petitioner is correct, there are no circumstances under which Section 722 would grant debtors more favorable treatment than Section 506(d). It is highly unlikely that Congress would have limited Section 722 so precisely if it was completely superfluous in light of Section 506(d).[11]

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[10] Basic property principles provide that if a debtor pays a creditor the entire sum secured by the collateral (that is, under petitioner's reading, the value of the collateral as determined by the bankruptcy court), there would be no remaining debt for the creditor's lien to secure, and thus the creditor no longer would be able to conduct a foreclosure sale. See 9 *Thompson on Real Property* § 4808 (J. Grimes ed. 1958 & Supp. 1981) (real property); U.C.C. § 9-506 (1978) (personal property). Of course, after a foreclosure is conducted, the entity that purchased at that sale would own the collateral and, absent some state-law right of redemption that continues after foreclosure, the debtor would be able to regain the collateral only by purchasing it from the subsequent owner. See *Thompson on Real Property, supra*, § 4822 (real property); U.C.C. § 9-504(4) (1978) (personal property).

[11] The consistently guarded approach that Congress took in deciding to alter the rights of lienholders is also apparent from Section 522(f), which grants the debtor a limited and carefully delineated right to avoid liens on exempt property. The power applies only to two particularly disfavored types of liens: (1) judicial liens and (2) nonpossessory, nonpurchase-money security interests in household goods, tools of the trade, or health aids. Thus, it never could apply to purchase-money security interests, any lien in real estate,

2. Petitioner's reading of Section 506(d) also undermines the incentives established by the finely reticulated provisions of Chapters 11 and 13. The distinction between a Chapter 7 bankruptcy, on the one hand, and a Chapter 11 or Chapter 13 bankruptcy, on the other hand, is fundamental. In a liquidation proceeding under Chapter 7, "the debtor gives up all non-exempt assets, the Trustee in Bankruptcy sells these assets, and the proceeds are distributed pro rata to creditors." E. Warren & J. Westbrook, *The Law of Debtors and Creditors* 179 (1986). By contrast, in a payout proceeding under Chapter 11 or 13, "a debtor can propose to keep all assets in exchange for promising to pay off debts over a period of time out of future income." *Ibid.*[12]

To encourage debtors to agree to use their future income to repay their debts in Chapter 11 and 13 proceedings, which theoretically benefit society because a debtor

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or, indeed, any bargained-for lien in personal property other than the especially favored types of property mentioned above. This provision's careful delineation of particular types of collateral and particular types of loans bespeaks an entirely more attentive and compromising attitude than petitioner's reading of Section 506, which suggests a Congress ready to alter creditors' rights wholesale, without any concern for the nature of the particular transaction being affected.

[12] It is important to recognize that a debtor's agreement to use its future income to pay its creditors has a dramatic effect on the amounts received by creditors. In Chapter 7 proceedings, the disproportionate majority of the cases produce nothing for general unsecured creditors. See, *e.g.*, Herbert & Pacitti, *Down and Out in Richmond, Virginia: The Distribution of Assets in Chapter 7 Bankruptcy Proceedings Closed During 1984-1987*, 22 U. Rich. L. Rev. 303, 310-311 (1988) (no assets for general unsecured creditors in 97% of Chapter 7 cases). Payout plans typically promise much more for creditors, see, *e.g.*, T. Sullivan, E. Warren & J. Westbrook, *As We Forgive Our Debtors* 45 n.27 (1989) (median repayment of 45% promised in confirmed Chapter 13 plans); LoPucki & Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. Pa. L. Rev. 125, 142 (1990) (median repayment of 27% in large Chapter 11 cases), although it is not clear exactly how much actually is repaid.

"can keep assets instead of liquidating them, often at sacrifice prices," E. Warren & J. Westbrook, *supra*, at 179, the Code not only allows debtors to keep their assets, it also provides a number of other benefits not available to debtors in Chapter 7 bankruptcies. Most important of these for this case are the specific provisions that authorize Chapter 11 plans that "impair * * * any class of claims, secured or unsecured," Section 1123(b)(1), and Chapter 13 plans that "modify the rights of holders of secured claims," Section 1322(b)(2).[13]

Not surprisingly, the Code does not trust blindly in the good will of debtors to ensure that they do not abuse the power to alter the rights of secured creditors. Thus, this power is strictly defined, in an attempt to see that it is exercised only to further legitimate bankruptcy purposes without unnecessarily harming the secured creditor. Most importantly, the plan must pay all nonconsenting creditors at least as much as they would receive in a Chapter 7 liquidation. Sections 1129(a)(7)(A), 1325(a)(4). Moreover, both Chapters prohibit confirmation of any plan in which the debtor retains collateral over the objection of a secured creditor unless the creditor retains a lien equal to the amount of its allowed secured claim, and is scheduled to receive under the plan property or payments with a present value equal to the amount of its allowed secured claim. See Sections 1129(b)(2)(A), 1325(a)(5).[14] Because obligations under the plan are obligations of the debtor that continue after bankruptcy,[15] the creditor thus receives, in return for any reduction of its lien, a personal and continuing obligation of the debtor to repay the debt up to the value of the collateral as determined by the bankruptcy court.

Moreover, both Chapters limit the circumstances under which debtors can reduce liens. First, a plan under Chapter 13 cannot alter the rights of a secured creditor holding a mortgage on the debtor's principal residence. Section 1322(b)(2). Second, in reorganizations under Chapter 11, where the greatest amount of money is likely to be at stake, a secured creditor has the right, by waiving any unsecured claim against the debtor, to prevent reduction of the amount of its lien by electing treatment under Section 1111(b)(2).[16]

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[13] Perhaps the most notable of the other benefits is the ability of a consumer debtor to receive a broader discharge in a Chapter 13 bankruptcy than he could in a Chapter 7 bankruptcy. Compare Section 1328(a) (exceptions from discharge after successful completion of a Chapter 13 plan) with Section 523(a) (exceptions from discharge under Chapters 7 and 11, or under Chapter 13, if debtor fails to complete payments under plan).

[14] Technically, it would be possible for a court to confirm a Chapter 11 plan over a creditor's objections without retaining these protections for the creditor by determining that the plan granted the creditor the "indubitable equivalent" of its claims, Section 1129(b)(2)(A)(iii), but it is unlikely that anything determined to be the indubitable equivalent would protect the creditor less than the protections outlined in the text, as the contemporaneous legislative explanations of the provision make clear. See 124 Cong. Rec. 32,407, 34,007 (1978).

[15] Section 1141(d)(1) accomplishes this for Chapter 11 plans, by providing for a discharge of pre-petition debts "[e]xcept as otherwise provided in * * * the plan." In Chapter 13 plans, this generally is accomplished by provisions in Sections 1328(a)(1) and 1328(c)(1) that prevent discharge of any debt that does not mature during the pendency of the plan (which is treated under Section 1322(b)(5)). It is possible, with respect to short-term secured claims, which do mature during the term of the plan, for a debtor who fails to complete payments under the plan to secure a discharge under Section 1328(b) without making all of the payments with respect to those claims, but the price for that debtor is that it must forgo the benefits of the broader discharge it would have received under Section 1328(a), see note 13, *supra*. Moreover, the creditor at that point would be entitled to take the collateral in satisfaction of the unpaid obligation, because, as mentioned in the text, the Chapter 13 plan must allow the creditor's lien to continue in effect securing the obligation of the debtor under the plan.

[16] Section 1111(b)(2) itself does not directly affect the amount of the lien, but simply allows the creditor to avoid the operation of Section 506(a) and treat its entire allowed claim as secured. But because Section 1129(b)(2)(A)(i)(I) prevents confirmation over a creditor's objection of a Chapter 11 plan that does not grant the

Petitioner's reading of Section 506(d) would allow debtors to shortcut these complicated creditor-protective provisions and receive a better deal under Section 506(d) —available in a Chapter 7 liquidation proceeding—than Congress offered debtors to encourage them to use their future income to pay off their debts under Chapters 11 and 13. Most obviously, petitioner's reading allows the lien to be stripped without requiring any personal obligation on the part of the debtor to repay *any* amount of the debt; a discharge under Section 724, unlike the discharges available in Chapters 11 and 13, protects the debtor from any further personal liability. Also, petitioner's reading makes lien-stripping available at the option of the debtor, without regard to the creditor's wishes, and thus would allow a Chapter 7 debtor to reap a windfall if a bankruptcy court undervalued property, by purchasing the property at the court's valuation, and immediately reselling it at a profit. This is difficult to reconcile with the Section 1111(b) election discussed above, which allows a creditor, after it can evaluate the value chosen by the bankruptcy court and the likelihood of recovery on its unsecured claim, to waive its unsecured claim and

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creditor a lien in the amount of its allowed secured claim, the inevitable effect of an 1111(b) election is to grant the creditor a lien for the full amount of its claim.

To be sure, the present value of the amounts required to be paid the creditor under Section ~~1129~~(b)(2)(A)(i)(II) is only the value of the collateral, rather than the total amount of the lien. Thus, a debtor faced with a Section 1111(b) election by an undersecured creditor must make payments to the creditor that total the amount of the claim, with a present value equal to the value of the collateral. Although many debtors may be able to satisfy this requirement without incurring any burden beyond the burden of paying the present value of the collateral (by extending the period over which payments are made), in many circumstances a Section 1111(b) election will make it extremely difficult for a debtor to avoid paying an undersecured creditor amounts with a present value that exceeds the value placed on the collateral by the bankruptcy court. See generally L. LoPucki, *Strategies for Creditors in Bankruptcy Proceedings* § 12.7.5 (1985).

then retain a lien for the full amount of its debt. Finally, petitioner's reading allows consumers in Chapter 7 bankruptcies to avoid the specific restrictions Congress imposed on consumer payout plans, which prevents modification of home mortgages, see Section 1322(b)(2). It is difficult to believe that Congress wrote the specific provisions in Chapters 11 and 13, granting debtors limited rights to reduce creditor's liens, with the understanding that Section 506(d) granted debtors a broad and unlimited right to do so unrestrained by any of the constraints articulated in Chapters 11 and 13.

Petitioner's approach takes an innocuous, though important, provision intended to effectuate the policy decisions reflected in the provisions of Section 502 that disallow disfavored claims, and transforms it into a major disruption of the finely tuned and harmonious scheme of debtor and creditor protections realized throughout the Code.[17]

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[17] Section 552 of the Code offers yet another example of the incongruous effects of petitioner's reading. Under that Section, a creditor is entitled to enforce provisions of a security agreement that grant the creditor a lien on proceeds, rents, and profits arising out of its collateral. It is hard to reconcile this broad protection of lien rights with the effect petitioner sees in Section 506, which deprives a creditor of future appreciation in the value of its collateral by locking in the value of a creditor's lien to a value of the collateral determined by the bankruptcy court. If Congress would let a creditor retain proceeds, rents, and profits—which necessarily increase the value of the security held by the creditor—it is hard to see why Congress would deprive the creditor of something much more fundamental to its bargain: the full value of its collateral as it may exist from time to time.

III. THE LEGISLATIVE HISTORY OF THE CODE DEMONSTRATES THAT SECTION 506(d) WAS AIMED ONLY AT DISALLOWED CLAIMS, AND THAT CONGRESS DID NOT CONTEMPLATE APPLICATION OF THE PROVISION TO UNSECURED CLAIMS

The language of Section 506(d) as enacted in 1978 first appeared in the 95th Congress in H.R. 8200.[18] The entire section-by-section analysis of this provision in the accompanying House Report explained:

> *Subsection (d) permits liens to pass through the bankruptcy case unaffected.* However, *if* a party in interest requests the court to determine and allow or disallow the claim secured by the lien under section 502 and *the claim is not allowed, then the lien is void to the extent that the claim is not allowed.* The voiding provision does not apply to claims disallowed only under section 502(e), which requires disallowance of certain claims against the debtor by a codebtor, surety, or guarantor for contribution or reimbursement.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 357 (1977) (emphases added). This passage makes two points important to this case. First, the first sentence indicates that the provision generally allows liens to pass through the bankruptcy unaffected, a concept directly opposed to petitioner's contention that the purpose of Section 506(d) is to strip liens to the judicially determined value of the collateral. Second, the passage suggests a single exception, for cases in which the creditor comes into the bankruptcy and the court disallows its claim. Nothing in this passage suggests the broad intent petitioner ascribes to this provision, and her reading makes a mockery of the Committee's promise that liens will pass through unaffected.

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[18] For a general discussion of the legislative history of Section 506, see 3 *Collier on Bankruptcy* ¶ 506.03 (L. King 15th ed. 1991).

The Senate introduced a comparable bill in the same Congress, S. 2266. This bill contained a similar version of Section 506(d), which differed only in the language of the exceptions. The section-by-section analysis of this bill displays a similar intent: "Subsection (d) provides that to the extent a secured claim is *not allowed*, its lien is void unless the holder had neither actual notice nor knowledge of the case, the lien was not listed by the debtor in a chapter 9 or 11 case or such claim was disallowed only under section 502(e)." S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978) (emphasis added).[19] Like the explanation in the House Report, the Senate Report shows that the purpose of Section 506(d) was to invalidate liens securing disallowed claims.[20]

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[19] It is fruitful to compare the legislative explanation of this provision to the explanation the Senate offered in the same report for Section 722, which, as discussed above, granted debtors a limited right of redemption with respect to certain types of personal property. The report explained: "This right to redeem is a very substantial change from current law." S. Rep. No. 989, *supra*, at 95. If petitioner were correct in reading Section 506(d) as an even broader weapon effectively granting an unconstrained right to redeem *any* type of collateral, surely the explanation for Section 506(d) at least would have alluded to this even more substantial change from prior law.

The introductory portion of the House Report did note that "[o]ne of the more significant changes from current law in proposed title 11 is the treatment of secured creditors and secured claims." H.R. Rep. No. 595, *supra*, at 180. But it went on to describe the specific change to which it was referring: the provisions of the bill that distinguish between secured and unsecured claims, rather than between secured and unsecured creditors. That relatively procedural change, of course, is indubitably clear on the face of Section 506(a). There is not a hint of the revolutionary import petitioner attaches to Section 506(d).

[20] Although there is no committee report explaining why Congress chose to enact the House version of Section 506(d), Senator DeConcini and Representative Edwards each introduced into the Congressional Record for his respective Chamber detailed comments explaining in substantially identical terms that the additional exception contained in the Senate bill (which protected tax authorities

In sum, Congress' contemporaneous explanations of the purpose of Section 506(d) explicitly describe its effect on a lien as turning on whether the claim is allowed or disallowed, not—as petitioner would have it—on whether the claim is secured or unsecured under Section 506(a). Under Section 506(d), "the lien is void to the extent that the claim is not allowed" (H.R. Rep. No. 595, *supra*, at 357)—not, as under petitioner's reading, to the extent that the claim is unsecured. Section 506(d) voids a lien "to the extent a secured claim is not allowed" (S. Rep. No. 989, *supra*, at 68)—not, as under petitioner's reading, to the extent an allowed claim is unsecured. There is not so much as a snippet of legislative history to suggest any relation between Section 506(d) and the bifurcation established by Section 506(a) or, indeed, any application of Section 506(d) to unsecured claims at all. It is almost unimaginable to believe that this is the kind of record one would find if Congress intended the provision to have the meaning urged by petitioner.[21]

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who had no knowledge of the bankruptcy) was deleted because it was superfluous in light of the general provision in the House bill that Section 506(d) would not void liens held by creditors that did not file in the bankruptcy. 124 Cong. Rec. 32,414-32,415, 34,014 (1978). Again, there is not a hint here that the provision should have any effect on unsecured claims.

[21] Section 506(d) was amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 448(b), 98 Stat. 374. The amendments did not affect the main portion of the provision, but only made technical correcting changes to the exceptions, and revised the language of the existing exceptions "to make clear that the failure of the secured creditor to file a proof of claim is not a basis for avoiding the lien of the secured creditor." S. Rep. No. 65, 98th Cong., 1st Sess. 79 (1983); see 3 *Collier on Bankruptcy* ¶ 506.03, at 506-14 (L. King 15th ed. 1991) (discussing the history of the amendment); *id.* ¶ 506.07, at 506-68 to 506-70, 506-72 to 506-73 (discussing problems in interpretation that led to the amendment).

IV. PETITIONER'S READING CONSTRUES SECTION 506(d) TO WORK A DRAMATIC AND UNEXPLAINED CHANGE IN PRE-CODE BANKRUPTCY LAW

As this Court has recognized for decades, Congress is "not writing on a clean slate" when it amends the bankruptcy laws. *Emil* v. *Hanley*, 318 U.S. 515, 521 (1943). Consequently, this Court has shown a considerable reluctance to accept arguments that would interpret vague or innocuous provisions of the Code to wreak major changes in pre-Code practice that are not discussed in the legislative history. "[A] major change in the existing rules would not likely have been made without specific provision in the text of the statute; it is most improbable that it would have been made without even any mention in the legislative history." *United Savings Ass'n* v. *Timbers of Inwood Forest Associates*, 484 U.S. 365, 380 (1988) (citation omitted).[22] Examination of pre-Code practice shows that the rule petitioner seeks would conflict with the meaning of prior law, as interpreted by this Court and understood by the Congress that drafted the Code.

Although many things may have been unclear about the treatment of secured creditors under the Bankruptcy Act of 1898, one bedrock principle was beyond dispute: absent some policy consideration specifically reflected in the Code, liens passed through bankruptcy unaffected.[23] Indeed, Section 67d of the Act made this explicit:

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[22] See, *e.g.*, *Pennsylvania Dep't of Public Welfare* v. *Davenport*, 110 S. Ct. at 2133 ("We will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure."); *United States* v. *Ron Pair Enterprises*, 489 U.S. 235, 245 (1989); *Kelly* v. *Robinson*, 479 U.S. 36, 47 (1986); *Midlantic Nat'l Bank* v. *New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501 (1986). For cases applying this rule to interpret bankruptcy statutes predating the Code, see *Emil* v. *Hanley*, 318 U.S. at 521; *Swarts* v. *Hammer*, 194 U.S. 441, 444 (1904).

[23] This Court recently acknowledged this general pre-Code rule in *Farrey* v. *Sanderfoot*, No. 90-350 (May 23, 1991), slip op. 6

> Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this Act.

30 Stat. 564.[24] Nor can it be said that the strong language of the statute was undermined by judicial exceptions. As this Court recognized, "Section 67d * * * declares that liens given or accepted in good faith and not in contemplation of or in fraud upon this act, shall not be affected by it." *City of Richmond* v. *Bird*, 249 U.S. 174, 177 (1919).[25]

("Ordinarily, liens and other secured interests survive bankruptcy."); see *Johnson* v. *Home State Bank*, No. 90-693 (June 10, 1991), slip op. 5 ("a bankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor *in personam*—while leaving intact another—namely, an action against the debtor *in rem*").

[24] The animus against liens incurred under questionable circumstances continues in the new Code. See Sections 547, 548.

[25] See also, *e.g.*, *City of Dallas* v. *Ryan* (*In re Brannon*), 62 F.2d 959, 961 (5th Cir.) ("[T]rue liens, however arising, which are not expressly invalidated by the Bankruptcy Act, remain good, and the trustee takes his title * * * subject to them."), cert. denied, 289 U.S. 742 (1933). See generally 4B *Collier on Bankruptcy* ¶ 70.70 (J. Moore 14th ed. 1979).

To be sure, the specific phrase regarding the continuing validity of liens was removed in a reorganization of this Section in 1938, but this seems to have been done not to remove the rule of validity, but instead because "the draftsmen of the 1938 Act desired generally to specify only what should be *invalid*." 4B *Collier on Bankruptcy* ¶ 70.70, at 771 (J. Moore 14th ed. 1979) (emphasis in original). There is no doubt that the alteration of the language had no substantive effect. As the Fifth Circuit explained:

> It is true that * * * the Chandler Act did not retain the old language saying expressly that liens valid in bankruptcy shall 'not be affected by anything herein,' but that provision was simply declaratory of the obvious import reflected, and still reflected, frequently in the substantive terms of the law, and the omission of such redundancy is not significant.

Oppenheimer v. *Oldham*, 178 F.2d 386, 389 (1949).

Examination of the Act's treatment of undersecured creditors confirms this understanding in the precise context relevant to the case at hand: outside of reorganization proceedings,[26] no provision of the Act countenanced involuntary reduction of the amount of a creditor's lien for any reason other than payment of the debt; the Act generally dealt only with *in personam* liabilities. Cf. *Johnson* v. *Home State Bank*, No. 90-693 (June 10, 1991), slip op. 5-6 (drawing a similar distinction in treatment of mortgages under the Code). Practice under the Act gave an undersecured creditor three options: "(1) to prove his claim as an *unsecured* claim and surrender his security; or (2) to prove his claim as a *secured* claim and give the bankrupt credit for the value of the security; or (3) not to prove at all and rely solely on the security." 3 *Collier on Bankruptcy* ¶ 57.07[3], at 169 (J. Moore 14th ed. 1976). The first option is irrelevant to our inquiry; if the creditor waives its lien, the effect on its rights is not involuntary. The third option grants the creditor rights analogous to the result under Section 506(d)(2): the lien passes through the bankruptcy unaffected. See 3 *Collier on Bankruptcy* ¶ 57.20[3] (J. Moore 14th ed. 1976). The second option most closely resembles the present facts, where the secured creditor attempts to receive a share of the bankrupt's estate to

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[26] Chapter X of the Act did permit modification of liens in connection with a plan of reorganization. 11 U.S.C. 616(1), 616(10) (1976). But this provision, like the analogous provisions in the new Chapters 11 and 13 discussed above, included a variety of mechanisms to protect the unconsenting creditor. See Section 616(7). The existence of this narrow provision, a precursor of the provisions of Chapters 11 and 13 discussed above, undermines petitioner's reading of Section 506(d) as a wide-ranging lien-stripping provision, by showing the longstanding tradition of allowing such a remedy only in connection with a reorganization proceeding that affords substantial protections to affected creditors.

compensate for a shortfall between the value of its collateral and the amount of its claim. In this situation, it is clear that the creditor was entitled to pursue the collateral to the full extent of its debt, even if the "security proved subsequently to be more valuable than estimated" in the bankruptcy court. *Id.* ¶ 57.20[6.2], at 359.[27]

The best illustration of the clear understanding of the inviolability of liens in bankruptcy proceedings is this Court's response to the Frazier-Lemke Act, a statute that indisputably did alter the rights of lienholders. As this Court explained, the "avowed object" of that Act—like petitioner's reading of Section 506(d)—"is to take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' to the present value of the property." *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 594 (1935). Under the Act, if the holder of a mortgage on a farm owned by a bankrupt consented, the debtor could buy the farm for its then appraised value by a series of payments over six years. If the creditor did not consent, the bankruptcy court would stay proceedings for five years, at which point the debtor could purchase the property for its appraised value, whether or not the creditor consented. *Id.* at 575-576.

In the course of invalidating this statute under the Takings Clause, this Court undertook a comprehensive examination of the rights of secured creditors against bankrupt debtors. It repeatedly rejected any notion that existing law forced creditors to suffer the intrusions petitioner finds in Section 506(d) of the Code. With respect

[27] There was some question as to what would happen if the creditor received more from the collateral than the amount of its outstanding debt. Apparently, "in this rare case," where the creditor had collected more than its full claim, the valuation of the collateral might be reconsidered, apparently so that the creditor could be forced to return any distribution it had received from the estate. See 3 *Collier on Bankruptcy* ¶ 57.20[6.2], at 358-359 (J. Moore 14th ed. 1976).

to the general law of creditor's rights, the Court explained: "No instance has been found, except under the Frazier-Lemke Act, of either a statute or decision compelling the mortgagee to relinquish the property to the mortgagor free of the lien unless the debt was paid in full." *Radford*, 295 U.S. at 579. With respect to national bankruptcy laws, the Court concluded that "none had, prior to the Frazier-Lemke amendment, sought to compel the holder of a mortgage to surrender to the bankrupt either the possession of the mortgaged property or the title, so long as any part of the debt thereby secured remained unpaid." *Id.* at 581-582. It noted that the federal bankruptcy laws had permitted certain property to be exempted from general creditors, but explained, by reference to the rule in *Long* v. *Bullard*, 117 U.S. 617, 620-621 (1886), that this had only a limited effect, because "unless the mortgagee released his security, in order to prove in bankruptcy for the full amount of the debt, a mortgage even of exempt property was not disturbed by bankruptcy proceedings." *Radford*, 295 U.S. at 582-583.

Finally, it is clear that Congress drafted and passed the Code with full understanding of this practice. As we mentioned above, the House Report accompanying Section 506(d) explicitly stated its understanding that the general import of Section 506(d) was to permit "liens to pass through the bankruptcy case unaffected." H.R. Rep. No. 595, *supra*, at 357. We submit that it passes belief that the House would have described a provision working the dramatic change petitioner sees in Section 506(d) by reference to the pre-Code maxim that liens pass through bankruptcy unaffected.

Congress' understanding of the law on this point appears even more clearly from the history of related provisions. For example, as mentioned above, when Congress drafted Section 722—the one provision in the Code that does allow a debtor in a liquidation case to retain collateral without paying the debts that encumber that col-

lateral—it noted that under the existing law, a debtor faced with an undersecured creditor "must pay more than the property is worth for the privilege of continuing to use the property." H.R. Rep. No. 595, *supra*, at 128. Congress could not have thought this statement to be correct if it had thought that the pre-Code law provided for the lien-stripping petitioner seeks to read into Section 506(d).

Finally, as this Court has recognized, a similar understanding is evident from the history of Section 522(c)(2)(A)(ii), which provides that a bankruptcy does not affect liens on exempt property unless the liens are voided under Section 506(d). If petitioner is correct, this provision would mean that liens on exempt property are unaffected only in the rare case in which the creditor is fully secured; under our reading, of course, the liens would be affected only if the claim was disallowed. The latter reading is the only one consistent with Congress' intent. Citing *Radford* and *Long* v. *Bullard*, both the House and the Senate Reports explained that Section 506(d) (as incorporated by reference into Section 522(c)) followed the rule that the "bankruptcy discharge does not prevent enforcement of valid liens," and that by enactment of Section 522(c) the Code was accepting this rule "with respect to the enforcement of valid liens on nonexempt property as well as on exempt property." H.R. Rep. No. 595, *supra*, at 361; S. Rep. No. 989, *supra*, at 76. This passage demonstrates two things. First, Congress clearly understood that existing law did not provide for any reduction in liens of undersecured creditors with allowed claims because of a bankruptcy of their debtors. Second, it thought that Section 506(d) carried that rule forward in the Code. See *Farrey* v. *Sanderfoot*, No. 90-350 (May 23, 1991), slip op. 6 (citations omitted) ("[I]t was well settled when § 522(f) was enacted that valid liens obtained before bankruptcy could be enforced on exempt property, including otherwise exempt homestead property. Congress generally preserved this principle when it comprehensively revised bankruptcy

law with the Bankruptcy Reform Act of 1978.").[28] Congress could not rationally have explained Section 522(c) in this manner if petitioner's reading of Section 506(d) was correct.

In sum, the text of Section 506(d) strongly indicates that the provision affects only a secured claim that is not allowed. The structure of the Code shows that this is a sensible reading, and that petitioner's reading is inconsistent with the painstaking approach Congress took in the provisions that affected the rights of lienholding creditors. Finally, the legislative history and pre-Code practice show a consistent history of protection for the rights of secured creditors that petitioner would have stripped by Section 506(d), and not a snippet of a suggestion that Congress intended to intrude on those rights here. At bottom, it is just not plausible that Congress could have granted debtors the broad new remedy against allowed unsecured claims that petitioner sees in Section 506(d) without specifically mentioning this powerful remedy someplace in the Code or in its legislative history.

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[28] See also *Johnson* v. *Home State Bank*, No. 90-693 (June 10, 1991), slip op. 4 ("Codifying the rule of *Long* v. *Bullard*, 117 U.S. 617 (1886), the Code provides that a creditor's right to foreclose on the mortgage survives or passes through the bankruptcy.").

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

STUART M. GERSON
Assistant Attorney General

JOHN G. ROBERTS, JR.
Deputy Solicitor General

RONALD J. MANN
Assistant to the Solicitor General

ALAN CHARLES RAUL
General Counsel
Department of Agriculture

ERIC S. BENDERSON
Associate General Counsel for Litigation
Small Business Administration

JUNE 1991

APPENDIX

§ 506. Determination of secured status

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

(c) The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

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No. 90-741

In the
Supreme Court of the United States

OCTOBER TERM, 1990

ALETHA DEWSNUP,
PETITIONER,
v.
LOUIS L. TIMM, JOHN NEIUWLAND AND FLOYD M. CHILDS, TRUSTEES OF THE UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., AND JOSEPH L. HENROID, AS TRUSTEE FOR THE ANNETT JACOB TRUST,
RESPONDENTS.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEAL FOR THE TENTH CIRCUIT

Brief of Consumers Education and Protective Association, Inc. as Amicus Curiae in Support of Petitioner

MICHAL FOX MIVASAIR
Counsel of Record
IRWIN TRAUSS
HENRY J. SOMMER
COMMUNITY LEGAL SERVICES, INC.
1315 Walnut Street, Suite 400
Philadelphia, Pennsylvania 19107
(215) 427-4850

ROBERT SABLE
NATIONAL CONSUMER LAW CENTER
11 Beacon Street
Boston, Massachusetts 02108

BATEMAN & SLADE, INC BOSTON, MASSACHUSETTS

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INTEREST OF AMICUS CURIAE

Amicus Consumer Education and Protective Association, Inc. (CEPA) is an organization of consumers which is dedicated to advancing the cause of consumer rights. CEPA considers the remedies afforded debtors under the Bankruptcy Code to be an important means of ameliorating the human costs which arise in an economic system in which business failures, with concomitant layoffs and unemployment, regularly occur.

Very often individuals buy homes with the assistance of purchase money mortgages which are adequately secured by the value of their homes. These same people, at a later date, may have their homes encumbered by junior liens in order to finance purchases of consumer goods or business ventures. The creditors are aware when they take these liens that there is little or no equity to support

them. The creditors do so solely for the leverage which the liens provide.

With the use of 11 U.S.C. §506, chapter 7 debtors can void these undersecured mortgages and can resume making payments on their purchase money mortgages, thus preserving their homes. If these individuals are barred from utilizing §506(d), they will not be able to effectuate their discharge; they will be forced to pay the junior undersecured lienholders under threat of foreclosure on their homes even when the creditor's lien is without value.

The Court's ruling in this case is critical to individual debtors who wish to retain their homes and get a true fresh start in bankruptcy.

SUMMARY OF ARGUMENT

The plain language of §506(d) of the Bankruptcy Code dictates that an undersecured lien on property in a chapter 7 case is void whether or not the property has been abandoned. This plain meaning is consistent with the purpose of §506(d), with its role in the Code's claim allowance scheme, and with providing debtors a fresh start.

The rationale relied upon by the lower court in deviating from the language of the statute would, if followed, lead to nonsensical results, including the evisceration of the debtor's right of redemption and the elimination of an undersecured creditor's ability to participate in the distribution of the estate's assets in a chapter 7 case.

The decision of the lower court should be reversed.

ARGUMENT

I. THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE PERMITS A CHAPTER 7 DEBTOR TO VOID LIENS ON REAL PROPERTY TO THE EXTENT THE LIENS EXCEED THE PROPERTY'S VALUE WITHOUT REGARD TO WHETHER THE PROPERTY HAS BEEN ABANDONED.

A. This Court's Inquiry Need Go No Further Than An Examination Of The Plain Language of the Code

The issue in this case is whether, pursuant to 11 U.S.C. §506(d), chapter 7 debtors may void liens on real property which has been abandoned by the trustee, to the extent the fair market value of the property is less than the amount of the liens.

As in all cases of statutory construction, the starting point in this case must be the statutory language itself. Pennsylvania Department of Public Welfare v. Davenport, 110 S.Ct. 2126, 2130 (1990); United States v. Ron Pair Enters., Inc., 109 S.Ct. 1026, 1030 (1989). "The plain meaning of legislation should be conclusive, except in

the rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of the drafters." Ron Pair, 109 S.Ct. at 1031 (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982)).

This is especially true in the bankruptcy context. Congress worked on the formulation of the Bankruptcy Code for nearly a decade. The Code was established to modernize the bankruptcy laws and as a result made major changes in the substantive laws of bankruptcy. Ron Pair, 109 S.Ct. at 1030. This legislative history bolsters the need to interpret the Bankruptcy Code by its plain language, manifesting Congressional intent. As this Court stated in Ron Pair, a decision concerning §506(b) of the Bankruptcy Code:

> In such a substantive overhaul of the system, it is not appropriate or realistic to expect Congress to have explained each step it took. Rather, as

> long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain meaning of the statute.

Ron Pair, 109 S.Ct. at 1030.

In this case, the language of the Code is clear. It dictates that in a Chapter 7 case, a lien on a debtor's real property is void to the extent it is undersecured so long as the lien is brought to the attention of the bankruptcy court. That the property is or may be abandoned in the future under §554 of the Code is irrelevant. 11 U.S.C. §§103(a), 506(a), 506(d).

Section 506 "governs the definition and treatment of secured claims, i.e., claims by creditors against the estate that are secured by a lien on property in which the estate has an interest." Ron Pair, 109 S.Ct. at 1029. The statute makes no distinction between liens on real property and liens on personal property. See In re Lindsey, 823 F.2d 189,

190 (7th Cir. 1987). "Subsection (a) of §506 provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured." Ron Pair, 109 S.Ct. at 1029; In re Hart, 923 F.2d 1410, 1413 (10th Cir. 1991); Gaglia v. First Federal Savings & Loan Ass'n., 889 F.2d 1304, 1308 (3rd Cir. 1990); Lindsey, 823 F.2d at 190; see In re Folendore, 862 F.2d 1537, 1539 (11th. Cir. 1989). To the extent the lien exceeds the value of the property, the lien secures a claim that is not an "allowed secured claim" and is void. 11 U.S.C. §506(d);[1] Gaglia, 889

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[1] 11 U.S.C. §506(d) has two limitations on voiding liens. Liens are not void if (1) the underlying claim is disallowed under §502(b)(5) or §502(e), which deal with unmatured debt and co-debtor claims, or (2) the claim is not an allowed secured claim due only to the failure of any party to file a proof of claim. Neither exception is relevant to the instant case.

F.2d at 1308; Folendore, 862 F.2d at 1538-39, (11th Cir. 1989).

Section 103(a), entitled "Applicability of Chapters", states:

> [C]hapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title.

Section 506 is found in chapter 5 of the Bankruptcy Code. Therefore the plain meaning of the Code's language unambiguously dictates the bifurcation of claims into secured claims and unsecured claims in all bankruptcy chapters, including chapter 7 bankruptcy cases. Hart, 923 F.2d at 1415 (chapter 13); Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123, 127-28 (3d Cir. 1990) (chapter 13); Gaglia 889 F.2d at 1311 (chapter 7); In re Hougland, 886 F.2d 1182, 1183, (9th Cir. 1989) (chapter 13); Folendore, 862 F.2d at 1538 (chapter 7); see In re Tarnow, 749 F.2d 464, 465 (9th Cir. 1984) (chapter 11). There is

simply nothing in the Bankruptcy Code which provides any authority for making §506(d) inapplicable to liens on property which has been abandoned nor any basis to find it less applicable in chapter 7 than in the reorganization chapters. See Gaglia, 889 F.2d at 1308.

Since the statute's language is plain, "the sole function of the courts is to enforce it according to its terms." Ron Pair, 109 S.Ct. at 1030 (quoting Caminetti v. United States, 242 U.S. 470, 485 (1917)).

B. If it Were Congress' Intent to Make §506 Inapplicable to Abandoned Property in a Chapter 7 Case it Would Have Placed The Restriction in the Code.

If Congress wished to restrict the applicability of §506 in a chapter 7 case to property not abandoned by the estate, Congress surely would have drafted such limiting language into the Bankruptcy Code itself. Congress has done so in chapter 11 of the

Bankruptcy Code where pursuant to §1111(b)(2),[2] undersecured nonrecourse creditors[3] may elect to override §§1111(b)(1)(A) and 506 (the combined effect of which provides nonrecourse undersecured creditors with a secured claim for the value of their collateral and with an unsecured recourse claim for the deficiency). Instead

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[2] Sections 1111(b)(1)(A) and (2) state in relevant part:

> (b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse. . .
>
> (2) If such an election is made, then **notwithstanding section 506(a) of this title**, such claim is a secured claim to the extent that such claim is allowed. (emphasis added).

[3] Nonrecourse creditors are limited to their pledged collateral to satisfy their claims and may not assert any deficiency claims against the debtor. Norton Bankruptcy Law & Practice §58.01 (1990).

these creditors may elect to waive their unsecured deficiency claims and have their claims treated as if they were fully secured in a debtor's chapter 11 plan. Norton Bankruptcy Law & Practice §58.02 (1990).

As the Third Circuit Court of Appeals in Gaglia observed:

> Section 1111(b)(1) is carefully drawn and uses specific, precise language. It demonstrates that Congress knew how to exempt certain creditors from the operation of §506, and could do so with precision. Considering this careful drafting, we are unwilling to read into §506 an exemption for an undersecured creditor when the property securing his claim is not liquidated in Chapter 7 proceedings.

Gaglia, 889 F.2d at 1311.

The absence of such limiting language in chapter 7 of the Bankruptcy Code indicates that Congress did not envision any exception to the applicability of §506 in chapter 7 cases. Nor did it include any limitation on

the applicability of §506 to liens on abandoned property.

II. THE BANKRUPTCY CODE'S PURPOSES AND POLICIES ARE EFFECTUATED BY APPLYING THE PLAIN MEANING OF 11 U.S.C. §506

As is demonstrated above, the plain meaning of 11 U.S.C. §506(d) dictates that an undersecured lien is void in a chapter 7 case even when that lien is on abandoned property. This result is also dictated by the purpose and operation of 11 U.S.C. §506(d) and by its role in the claim allowance scheme.

Contrary to the assertion of the court below, 11 U.S.C. §§506(a) and (d) are not in the Code simply to "facilitate valuation and distribution in the reorganization chapters of the code." In re Dewsnup, 908 F.2d 588, 591 (10th Cir. 1990). They are also necessary to permit the final "adjustment of the debtor ... creditor relationship." 28 U.S.C. §157(b)(2)(O). This adjustment is essential

to the two basic purposes of a chapter 7 bankruptcy - to accomplish a fair and equitable distribution of the assets of the debtor to secured and unsecured creditors and to provide the debtor with a fresh start. Folendore, 862 F.2d at 1540; Grogan v. Garner, 111 S.Ct. 654, 659 (1991). Both of these purposes require the voiding of any lien to the extent it is determined to be without validity or worth by the bankruptcy court. This result is also dictated by the role which §506 plays in the claim determination and allowance process contained in the Code.

A. The Voiding of an Undersecured Lien on Abandoned Property in a Chapter 7 Case is Consistent With the Fair and Equitable Distribution of the Assets of the Estate

One significant motivation for enacting §506 was to address the manner in which creditors who were undersecured lienholders at the time of the petition would be treated in bankruptcy - both in liquidation cases and in reorganization cases." Congress, by enacting §506, struck a balance between competing interests of various parties to a bankruptcy proceeding.

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[4] It is explicit in §4-402 of the bill drafted by the Commission on the Bankruptcy Laws of the United States, which originated the concept of bifurcating undersecured claims now found in §506(a), that the undersecured part of a claim is unsecured in both liquidation and reorganization cases. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93rd Cong., 1st Sess., Pt. II (1973). The concept that bifurcating claims applies to both liquidations and reorganizations was carried forward in all subsequent bills. See "Legislative History of Section 506" 3 Collier on Bankruptcy ¶506.3 (15th ed. 1990).

The legislators were concerned that a creditor who was undersecured at the time of the petition should not be excluded from participating in the general distribution of the estate. At the same time Congress did not want the secured creditor to be paid twice - once from the realization of its interest in the security and a second time from the proceeds of the distribution. See S. Rep. No. 95-989, 95th Cong. 2d Sess. 68 (1978). Congress also intended that the debtor, and not the creditor, benefit from the increase in equity ownership resulting from the debtor's using postpetition assets to pay down prepetition liens.[5] Gaglia, 889 F.2d at 1309.

Section 506(a) provides a means of accomplishing these goals by creating a

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[5] See the discussion of the role §506(d) plays in preserving the debtor's fresh start in part II. C. below.

mechanism which "separates an undersecured creditor's claim into two parts: He has a secured claim to the extent of the value of his collateral, and he has an unsecured claim for the balance of his claim." * Section 506(d) completes the solution by voiding the creditor's lien to the extent it exceeds the value of the collateral.

The bifurcation of the claim into secured and unsecured portions allows the undersecured creditor to look to its collateral for payment of its claim up to the value of the collateral and to participate with the other unsecured creditors in the distribution of the estate. The creditor can only participate in the

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* S. Rep. No. 95-989, 95th Cong. 2d Sess. 68 (1978). The Senate version of §506(a) of the Code, was ultimately enacted as part of amended H.R. 8200. See §506(a) of H.R. 8200, amendment adopted on September 28, 1978 at 124 Cong. Rec. to H. 11,057 (daily ed. Sept. 28, 1978).

distribution to the extent its claim exceeds the value of the collateral. Thus the creditor is precluded by the §506(a) bifurcation from receiving double payment of the **secured** portion of its claim. The voiding of the lien under §506(d) prevents the undersecured creditor from receiving double payment on the **unsecured** portion of its claim.

The principle which motivated Congress to provide for the bifurcation of undersecured claims is the same whether the property subject to the security is abandoned or not. By holding that §506(a) never comes into effect to bifurcate a claim if property has been abandoned, the court below potentially deprived it of almost all meaning and clearly defeated its purpose. If property is subject to liens which exceed its value, the property is virtually always abandoned in a chapter 7 case sooner or later. A trustee could never

realize any funds for the estate by selling it, and even if the property is not affirmatively abandoned during the case, it is normally deemed abandoned upon the closing of the case. 11 U.S.C. §554(c).

If the holding of the court below were adopted, an undersecured creditor would be precluded from participating in the distribution of the assets of the estate in every chapter 7 case. An undersecured creditor could never have an allowed unsecured claim because, due to the abandonment or potential abandonment of the overencumbered property, the undersecured creditor's claim could not be bifurcated under §506(a). This is clearly inconsistent with how §506 of the Code was intended to operate.

B. The Role of §506 in the Overall Claim Allowance Scheme of the Code Dictates That §506(d) is Available to Void the Undersecured Portion of a Lien on Property That has Been Abandoned

Section 506, entitled "Determination of secured status", is part of the claims determination scheme of the Code. In re Tanner, 14 B.R. 933, 936 (Bankr W.D. Pa. 1981); see, Wilson, 895 F.2d at 126-127 (character of a creditor's claim is determined by reference to §506). It is found in Subchapter I of Chapter 5 entitled "Creditors and Claims". The sections of this subchapter collectively define the procedures and the substantive standards under which claims are filed, determined, and classified under all chapters of the Code.

When a claim is brought to the attention of the bankruptcy court, the court is constrained by §502(b) to determine "the amount of such claim in lawful currency of the

United States **as of the date of the filing of the petition**" and to allow the claim "in such amount" except to the extent the claim must be disallowed under subsections (1) - (7) of §502(b). 11 U.S.C. §502(b)(emphasis added). After the claim is determined and allowed it is then subject to classification under other sections of Subchapter I.

With some exceptions not here applicable', the Code contemplates a claims process that freezes the respective rights of the debtor and his or her creditors as of the date of the petition. See Tanner, 14 B.R. at 937. Events subsequent to the petition date, such as abandonment, are not relevant to the determination of claims against the debtor or against the property of the debtor. See 11 U.S.C. §502(b).

See e.g. 11 U.S.C. §§ 502(f)-(i).

Section 506 provides the means for classifying claims that have been "allowed" under §502 into "allowed secured claims" and defines what is an allowed "secured claim". Section 506(a) bifurcates "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest" into secured and unsecured components. 11 U.S.C. §506(a). Just as the claim is determined and allowed under §502(b) "as of the date of the filing of the petition", the allowed claim is treated as secured or unsecured to the extent the claim is secured by a lien on property in which the estate has an interest "as of the date of the filing of the petition." The subsequent abandonment of the property is irrelevant.

Because §506 effects secured creditors, unsecured creditors and the debtor, the Code permits each of these participants to bring the provisions of §506(d) into play even when

the others fail to do so. 11 U.S.C. §§506(d)(2) and 501(c); Bankruptcy Rule 3004; Gaglia, 889 F.2d at 1307 and 1309. The use of §506 in a Chapter 7 case was explained by Judge Posner, writing for the Seventh Circuit Court of Appeals as follows:

> The presence of the mortgagees in the bankruptcy proceeding requires comment, in view of the old saw (which, as this case shows, is no better than a half-truth) that liens pass through bankruptcy unaffected. See e.g. Tarnow, 749 F.2d 464, 466 (7th Cir. 1984). A lienor need not, in order to enforce his lien, file a claim in his debtor's bankruptcy proceeding, though if he does not he loses the chance of enforcing any deficiency judgment against the assets of the bankrupt estate. Since the Lindseys had no assets other than those secured by the mortgages, the mortgagees had no incentive to seek a deficiency judgment, hence no incentive to file a claim in bankruptcy. If, therefore, liens truly passed through bankruptcy unaffected, the mortgagees would not have been dragged into the bankruptcy proceeding at all, since they were content to foreclose on their liens. But then how are sections 506(a) and (d) provisions that apply only to liens and hurt the lienor -- ever brought into play? One possibility is that they are brought into play only when the lienor wanting to have an unsecured

> claim against the bankruptcy estate to the extent of any difference between the value of his lien and the amount of money owed him by the debtor, has voluntarily filed a claim in bankruptcy. This interpretation, which makes section 506 merely an optional creditor's remedy, is consistent with the notion that liens pass through bankruptcy unaffected, but overlooks the significance of section 506(d) when read together with section 501, which governs proof of claims. Section 501(c) authorizes the debtor as well as the creditor to file a proof of claim including proof of a secured claim under section 506(a). Such a filing not only drags the secured creditor into the bankruptcy proceeding against his will but brings section 506(d) into play, that is, strips down the lien, even if the lienor would have preferred to bypass the bankruptcy proceeding completely.

Lindsey, 823 F.2d at 190-191.

The debtor's ability, independent of the trustee, to bring the provisions of §506(d) into play is additional evidence that Congress intended §506(d) to apply in a Chapter 7 case irrespective of whether collateral has been abandoned. See, Gaglia, 889 F.2d at 1309. Ordinarily, a trustee in a chapter 7 case has no reason to file a proof of claim for a

secured creditor whose collateral has been abandoned under §554. By filing such a claim the trustee would only dilute any distribution to the unsecured creditors by adding the undersecured portion of the lienholder's claim to the total of the unsecured claims.

The debtor however, continues to have an interest in a final determination of the extent of the creditor's claim against the debtor and against his or her property. For example, the debtor may dispute the extent or the validity of the lien under state law and may wish to bring that dispute to the attention of the bankruptcy court. See 11 U.S.C. §502(b)(2); Tarnow, 749 F.2d at 465-456 (when the bankruptcy court allows or disallows a secured claim it also determines validity of the lien).[8] If the provisions of §506 were

[8] The debtor may wish to have the claim determined for additional reasons related to his fresh start. Some of these reasons are discussed in Part II. C below.

unavailable whenever property was abandoned, the debtor would be unable to effectively challenge the claim of an undersecured creditor in a chapter 7 case."[9]

[9] This is evident from an examination of the relationship between 11 U.S.C. §§502 and 506(d). Contrary to the suggestion of the court below, §506(d) is not brought into play only after an allowed claim is bifurcated into secured and unsecured claims under §506(a). See Dewsnup, 908 F.2d at 591-592. Section §506(d) is applicable whenever a secured claim is determined by the bankruptcy court.

Section 506(a) applies only to "allowed claims". In contrast, a lien is void under §506(d) to the extent the "lien secures a claim against the debtor that is **not an allowed secured claim** ...." 11 U.S.C. §506(d) (emphasis added). When a lien secures a claim against the debtor that is disallowed pursuant to §502(b) the lien secures a claim against the debtor that is "not an allowed secured claim" and is void under 506(d). Thus, if a claim secured by a lien is contested "on the ground that the loan had never been made, or that it had been completely repaid, or that repayment could not be made because the loan was usurious and if the bankruptcy court

(continued...)

This reading of §506(d) would give the holders of the most spurious claims the greatest power to harass the debtor after the bankruptcy and to frustrate the debtor's fresh start. See H.R. Rep. 95-595, 95th Cong., 1st Sess. 124 (1977). This is clearly not what Congress intended. See 11 U.S.C.§524.[10]

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*(...continued)
agreed that the [debtor] had no legally enforceable obligation to the creditor" and disallowed the claim, the lien, pursuant to §506(d), "fall[s] with the claim". Tarnow, 749 F.2d at 465-466.

Under the lower court's reading of §506(d), if the property subject to a lien is abandoned in a chapter 7 case, §506(d) can't apply. Dewsnup, 908 F.2d at 591. The lien on abandoned property that secures a claim that is disallowed would not be void. The debtor would be left to relitigate the validity of the lien in state court.

[10] Section 524(a) of the Code embodies the desire of Congress to insulate the debtor, "especially the 'little guy' who is the subject of the typical 'consumer'... bankruptcy" from the harassment which results when the debtor is left to burdensome litigation in state court to enforce the (continued...)

C. The Role of §506(d) in Effectuating the Debtor's Fresh Start Dictates That it be Applied to Abandoned Property in a Chapter 7 Case

It may at first blush seem harsh to permit debtors to void liens on their real property. This power to void undersecured debt however, merely effectuates the real world marketplace result by duplicating within bankruptcy that which would have occurred outside bankruptcy in a liquidation sale. Gaglia, 889 F.2d at 1308; Lindsey, 823 F.2d at 191. In fact, respondents have conceded that mortgage lenders are not often hurt by the judicially determined value of their secured claim instead of the value actually brought at a foreclosure sale. Brief for Respondents in Opposition to Certiorari at 8-9. A partially

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[10](...continued)
rights which the bankruptcy affords. See 3 Collier on Bankruptcy, ¶524.01[01] (15th ed. 1991). This desire is also manifested by the provisions of §506(d).

or fully undersecured creditor would receive little or nothing from such a sale. Lindsey, 823 F.2d at 191. Avoiding the undersecured portion of a mortgage lien deprives the creditor solely of this empty legal right. Tanner, 14 B.R. at 38.

What apparently disturbed the lower court was that the debtors might be able to keep their farm by paying the creditor the value of the property if §506(d) was applied as written. The court inserted into the Bankruptcy Code a policy of its own invention that undersecured creditors have the right to receive title to the property on which they have undersecured liens at forced sales in order to have the opportunity to speculate upon them. Dewsnup, 908 F.2d at 593. Congress, on the other hand, determined that creditors with secured claims should receive in bankruptcy what their collateral is worth

at the time of the bankruptcy and receive distribution with unsecured creditors for the balance of their undersecured claims.

The Dewsnup court failed to observe that nothing stops these undersecured creditors from attending other forced sales in the debtor's locale and from purchasing similar properties to speculate on. The Bankruptcy Code was simply not written to protect this concern of potential speculators. Accord, Tanner, 14 B.R. at 937. Quite to the contrary, any postpetition appreciation in the value of a debtor's property or reduction in the value of senior liens is to inure to the benefit of the debtor under the fresh start principle and not to undersecured lienholders. E.g. Gaglia, 889 F.2d at 1309; In re Harris, 94 B.R. 832, 836 (D.N.J. 1989); In re Crouch, 76 B.R. 91, 94 (Bankr. W.D.Va. 1987).

The Bankruptcy Code must be interpreted to accomplish its purposes, one of which is to provide debtors with a fresh start." H.R. Rep. 95-595 at 117-8. The 11th Circuit in Folendore addressed the fresh start policy underlying the Bankruptcy Code and the interplay with §506 as follows:

> The whole point of bankruptcy is to provide a debtor with a fresh start. Section 506 allows the debtor the option to begin anew on its former property. Section 506 does not give a debtor his property back as some sort of windfall. It simply permits the debtor to eventually repurchase an equity in it, something the [mortgage lender] admits it has the right to do on any other piece of land.

Folendore, 862 F.2d at 1540.

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[11] In Grogan v. Garner, 111 S.Ct. 654, 659 (1991), this Court reaffirmed "that a central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."' (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

Most often debtors invoke §506 as a preliminary step in their efforts to save their homes from foreclosure. The Gaglia court pointed out how §506 can be of critical importance in this effort:

> While the [creditor] is no worse off than if the property were sold, the [homeowners] may realize significant benefits from lien avoidance. They may be better able to negotiate a repayment schedule with the [creditor] for the reduced amount of the secured claim. Thus, they have an increased chance to retain their homestead. On the other hand, if §506 is not applied and the property is not liquidated, the [homeowners] will hold a mortgage exceeding $200,000 on property allegedly worth $38,000. The [homeowners] would have little incentive to remain on the property, since [the homeowners] could only get a good title after paying far more than what the property is worth. This is especially true since the [creditor] could foreclose at any time and realize whatever equity the [homeowners] had generated.

Gaglia, 889 F.2d at 1308; see Folendore, 862 F.2d at 1540.

Moreover, the fresh start implies that debtors must not be strapped with

undersecured, unsecured or disallowed prepetition debt. In most states, any creditor can demand a second, third or even fourth mortgage on a debtor's home in most consumer credit transactions even where the debtor's residence is already fully encumbered. If the debtor later files a chapter 7 bankruptcy case and is not permitted to strip down the wholly or partially unsecured mortgages, creditors will have succeeded in circumventing the bankruptcy discharge by immunizing themselves from the discharge. After the bankruptcy case, with the mortgage liens still in place, creditors can threaten to schedule a foreclosure if the entire debt is not paid. Faced with these threats a debtor often will pay the entire debt even though in reality it is completely or partially unsecured and should have been discharged to that extent. See Gaglia, 889

F.2d at 1308-9; Lindsey, 823 F.2d at 191.

This fresh start principle in no way prejudices prudent mortgage lenders. The ratio of collateral value to loan amount which a mortgage lender approves when it agrees to extend a loan is solely within a mortgage lender's control. Hougland, 886 F.2d at 1184. As the 9th Circuit noted, "[O]ne would think that most residential real estate lenders would see to it that they had a sufficient cushion to avoid finding themselves in an undersecured position." Hougland, 886 F.2d at 1184.

In fact, most purchase money mortgages are amply secured due to the combined effect of payments by mortgagors and appreciation of housing values. In re Caster, 77 B.R. 8, 13 (Bankr. E.D. Pa. 1987). To the extent any mortgage lender is undersecured, the lender in the bankruptcy will share in the distribution with other unsecured creditors.

III. THE COURT OF APPEAL'S ARGUMENTS FOR EVISCERATING §506 ARE WRONG AND LEAD TO ABSURD RESULTS

The court below offers several reasons for deviating from the plain language of the statute and for refusing to avoid undersecured liens. None of the reasons advanced by the lower court justify the repudiation of the plain language of the statute.

A. The Construction Given to §506(a) By The Court Below Deprives That Section of Any Meaning and Would Lead to Nonsensical Results

1. The court below adopted inconsistent interpretations of statutory terms depending upon the results it desired.

Attempting to avoid the readily apparent meaning of the plain language of the statute discussed above, the court of appeals in this case adopted its own "plain language" interpretation of §506(a), an interpretation which must be described as strained, to say the least. Although the estate clearly had an

interest in the property involved at the time of the §506 proceeding in the bankruptcy court, the court found that the property was not property in which the estate had an interest because it was abandoned at some point later in the case. Dewsnup, 908 F.2d at 591. At the same time, the court held that in chapter 11, 12 and 13 cases the estate has an interest in property even after it is abandoned. Id.

To arrive at this result, the court below seems to have used a shifting and elusive definition of the word "interest" in §506. On the one hand, in deciding that the estate had no interest in the property after it was abandoned in a chapter 7 case, the court appears to have adopted a meaning limited to a property interest belonging to the estate throughout the duration of the bankruptcy case. On the other hand, by holding that a

chapter 11, 12 or 13 estate still has an interest in the property after it is abandoned, the court appears to adopt some other meaning, because the estate has no more of a property interest after abandonment in those chapters than it does in chapter 7.

This second meaning is never made entirely clear by the court below, but it seems broader than the concept of property of the estate. It is apparently an interest in property other than a pure property interest, and is implicated if the debtor proposes to "deal with and affect abandoned and/or exempted property". Id.

Certainly, neither §554 of the Code nor any other specific section of the Code provides for differing effects of abandonment, or differing meanings of the term "interest" in §506, depending upon the chapter in which it is applied. The court below cites no

authority for its odd conclusions in this regard. It would be strange indeed if Congress had desired the same word in the same provision to have two different meanings, an approach which is hardly consistent with the "plain language" doctrine that the court below claimed to be embracing or with §103(a), making §506 and §554 generally applicable in all chapters."[12]

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[12] There is no need to decide between these two possible meanings of "interest" if the Court looks simply to the property interest of the estate as of the time the case is commenced, when creditors' rights are generally fixed. See Part II. B. supra.

2. The holding below would prevent application of §506(a) where Congress obviously intended it to be applied.

It is not surprising, however, that the court below felt the need to "save" chapters 11, 12 and 13 from its interpretation of the language of §506(a). Since §554 is applicable to all Code chapters, property can be abandoned in those chapters just as it can be abandoned in chapter 7. And, under the lower court's interpretation of §506(a) for chapter 7 cases, an undersecured creditor might then have no allowed secured claim that could be provided for in a chapter 11, 12 or 13 case. Since providing for allowed secured claims is among the most important functions of a plan under those chapters, it would make no sense at all to read §506(a) in cases under chapters 11, 12 and 13 as the court below read it for chapter 7 cases. See 11 U.S.C. §§1129(b)(2), 1225(a)(5), 1325(a)(5).

Under the holding below, §506(a) also could not be applied where there were distributions to unsecured creditors from other estate property so that undersecured creditors could realize some value based upon their deficiency claims. See discussion at part II. B. supra.

Even §722, which the court below points to as the debtor's only remedy with respect to overencumbered property in chapter 7, would make no sense under that court's reading of §506(a). Under §722, the debtor may redeem **abandoned** personal property by paying to the holder of the lien "the amount of **the allowed secured claim** of such holder...." (emphasis supplied). Yet, under the lower court's interpretation of §506(a), there could either never be a determination of the allowed secured claim under §506(a) or else that allowed secured claim would be zero in every

chapter 7 case.

As one bankruptcy court explained, this anomalous result would be the logical conclusion if §506(a) was read to exclude property that was exempted or in which the estate's interest might be ultimately abandoned:

> I also think [the creditor's] argument really goes farther than it would like. If its reading is correct, then since the estate now has no interest and since §506 says that a claim is a secured claim only to the extent of the creditor's interest in the estate's interest in such property, then since the estate's interest is zero, the creditor's interest is zero and therefore [the creditor] does not have any allowed secured claim. Therefore under §506(d) its lien is completely void as would be the liens of all creditors secured on exempt property. Obviously, Congress never intended that result.

In re Gibbs, 44 B.R. 475, 479 (Bankr. D. Minn. 1984).

Finally, having the right to utilize §506 turn on the abandonment of property would have

peculiar results unrelated to any possible Congressional policy. It would create a race to the courthouse, with the debtor or the trustee seeking to obtain a final determination under §506(a) before a party could move that the property should be abandoned.[13] It is hard to imagine any reason Congress would have wanted to encourage such a race or to have the right to invoke §506 depend upon who won.

There would also be litigation over whether the property should be abandoned, since debtors would argue that property of the estate clearly includes exempt property that should be preserved for the debtor's fresh

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[13] The trustee may abandon property only after notice and a hearing. 11 U.S.C. §554(a). Any other party seeking abandonment of property must file a motion to be decided by the court. 11 U.S.C. §554(b).

start.[14] There is no question that the debtor would usually have at least equitable and possessory interests, as well as a legal title interest in the property, which could be exempted. See United States v. Whiting Pools, Inc., 462 U.S. 198, 204-5 (1983).[15] Again, it

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[14] In enacting the Code, Congress made clear that, unlike under the former Bankruptcy Act, property of the estate under the Code includes exempt property. The broad definition of property of the estate in 11 U.S.C.§§541(a) was intended to have the effect of overruling Lockwood v. Exchange Bank, 190 U.S. 294 (1903), which had held that under the former Act exempt property was not property of the estate. See H.R. Rep. 95-595 at 368.

[15] In Whiting Pools, this Court rejected a restrictive approach to the debtor's rights similar to that espoused by the court below. As in this case, a secured creditor argued that the Code's turnover provision, §542, could be applied only with respect to property rights the estate possessed at the time and could not expand the debtor's rights, even with respect to possession. This Court rejected that crabbed interpretation, which it found would have rendered §542 virtually superfluous. See 462 U.S. at 207, n.15. Similarly, as argued herein, the approach of

(continued...)

is difficult to see what possible policy would be served by encouraging such litigation, which would serve no useful purpose.

All of the above problems and inconsistencies result only if this Court adopts the strained reading of §506 accepted by the court below. Only a handful of courts, at most, have adopted this reading of the statute, with the applicability of §506 dependent on whether property has been, or could in the future be, abandoned. As discussed above, all other courts of appeals to address the issue have reached a different conclusion, which creates none of the anomalous results that would necessarily follow from the ruling of the court below.

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[15](...continued)
the court below in this case would render §506(a) largely meaningless in chapter 7 cases as well as many other cases.

B. The Provisions of §722 are Consistent with the Plain Language of §506(d) and with the Voiding of Liens on Abandoned Property in a Chapter 7 Case

The court below concluded that the presence of §722 in the Code supported its refusal to apply the plain language of §506(d). Dewsnup, 908 F.2d at 590 and 592 (allowing avoidance pursuant to §506(d) renders the redemption provision in §722 meaningless and permits the redemption of real property not intended by §722). In fact, §722 provides no support for the lower court's tortured reading of §§ 506(a) and (d).

There is simply no inconsistency between the plain language of §722 and the provisions of §506(d) and no mention, either in the language of the Code or in the legislative history, that Congress intended §722 to preempt the treatment of secured claims in

chapter 7 cases."[16] In re Mays, 85 B.R. 955,

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[16] To the contrary, in his testimony before both the House and the Senate opposing the inclusion of a separate right of redemption, Linn K. Twinem, Esquire, a creditor's representative, described the procedure for limiting secured claims to the value of the collateral under a provision that was to become §506(d) and then stated:

> To give the debtor **still another type of additional protection,** it is proposed that a debtor be allowed to redeem collateral security [sic] a discharged consumer debt by paying its appraised value if such value is less than the amount of the debt.

Hearings Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary on H.R. 31 and 32, 94th Cong. 1st & 2d Sess. 904 (1975) (Statement of attorney Linn K. Twinem on behalf of the Beneficial Finance System) (emphasis added); Hearings Before the Subcomm. on Improvements in Judicial Machinery of the Comm. on the Judiciary on S. 235 and S. 236, 94th Cong. 1st Sess. 192 (1975).

Throughout the extensive reports and hearings preceding the 1978 enactment of the Code, counsel can find no report, testimony or commentary on the right of redemption for consumer goods which suggests that the right of redemption was considered to be an exclusive remedy.

959 (Bankr. E.D.Pa. 1988), aff'd 1988 U.S. Dist. Lexis 8427 (E.D. Pa. August 1, 1988); (cited with approval in Gaglia, 889 F.2d at 1310); Gibbs, 44 B.R. at 478. In fact, §722 itself would not make sense if liens on abandoned property were not void under §506(d).

The court below correctly observed that §722 is a redemption statute. Dewsnup, 908 F.2d at 592. It failed, however, to observe that §506(d) is not. Gaglia, 889 F.2d at 1310; Folendore, 862 F.2d at 1540. Section 722 was included in the Code to provide debtors with certain affirmative redemption rights that they might otherwise not have under applicable non-bankruptcy law. H.R. No. 95-595 at 380-381. It also provides debtors with a simplified procedure to effectuate redemption in the bankruptcy court. Mays, 85 B.R. at 959; see 4 Collier at ¶722.05.

In the absence of §722, debtors in many cases would have no state law right to prevent their property from being sold to satisfy a secured debt by paying the value of the property. The right to redeem repossessed collateral under §9-506 of the Uniform Commercial Code simply provides debtors the right to recover repossessed property by paying the entire contractual amount due plus expenses, attorney's fees and legal expenses. U.C.C. §9-506. When repossessed collateral is sold, debtors do not even have the right to be present at the sale. They have no right of first refusal, i.e. no guarantee that they will be able to purchase the collateral at its fair value. See U.C.C. §§9-504(a) and (c).

Section 722 provides debtors with the right of first refusal, the right to repurchase the property for what it is worth. H.R. Rep. 95-595 at 381. 4 Collier at

¶722.01[1].

In contrast §506(d) simply determines the extent to which a creditor's lien will survive the bankruptcy. See In re Crouch, 76 B.R. 91, 93 (Bankr. W.D. Va. 1987). It in no way effects or modifies the creditor's right to enforce that lien after the bankruptcy is over. Gaglia, 889 F.2d at 1310; Lindsey, 823 F.2d at 191.

In this respect §506(d) is not unique, as it is but one of many chapter 5 provisions that speak to which liens will and will not survive the bankruptcy. See e.g. §522(f)(1)(avoidance of judicial liens on exempt property); §522(f)(2)(avoidance of certain non-possessory non-purchase money liens on exempt property). See also §§ 522(g),(h) and §545 (avoidance of certain statutory liens); §547 (avoidance of certain preferential transfers including the creation

of liens under certain circumstances); §548 (avoidance by the debtor of certain involuntary transfers, including the creation of liens that are not for fair value).

Though none of these provisions are intended as redemption provisions, they could all enable a debtor to essentially redeem liened property, including real property, that is not covered by §722. The reasoning of the court below that §722 is the debtor's exclusive remedy in a chapter 7 case for dealing with secured creditors would, if taken to its logical conclusion, require the lien avoidance provisions, in §§522(f)(1), and (2) and in the numerous other provisions of the Code mentioned above, to be unavailable to chapter 7 debtors. This reasoning is, in the words of one bankruptcy court, "not only dangerously presumptive, but plainly wrong". Mays, 85 B.R. at 959.

When pointing to §722 as support for its refusal to apply §506(d), the court below conveniently ignores the problems which its reading of §506(d) creates in the operation of §722. As is briefly pointed out above in Part III. A. 2., these problems render §722 meaningless as applied to abandoned property.

The redemption rights created by §722 apply to certain property that is subject to a "**lien** securing a dischargeable consumer debt, if such property is...abandoned under §554..." (emphasis added). The amount the debtor must pay to the holder of the lien to redeem the property pursuant to §722 is "the amount of the **allowed secured claim** of such holder that is secured by such lien." (Emphasis added).

Section 722, by its plain language, requires the application of §§506(a) and (d) in order to determine the extent of the "allowed secured claim" and thus the extent of

the "lien" from which the property must be redeemed. If §§506(a) and (d) are not applicable to abandoned property in a chapter 7 case, §722 itself cannot be applied to abandoned property."

At the same time, the status of the creditor's lien on the property would remain in doubt, even when the collateral had virtually no value, since, according to the lower court, §506(d) is unavailable to void any part of a lien on abandoned property. Debtors would be left to state court to assert that a creditor's lien was extinguished by the redemption.

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[17] As was pointed out above in Part III. A., the result is nonsensical - either §722 could never be applied to abandoned property, despite the explicit language making it applicable to such property; or the amount the debtor would have to pay to redeem abandoned property would be zero in every chapter 7 case.

In the final analysis, the lower court's reading of §506(d) would completely obliterate the benefits of §722. This is, of course, not what Congress intended. Further, §722 provides no support for the lower court's construction of §506(d). Accord 4 Collier at ¶722.01. It simply provides additional support for applying §506 in accordance with its plain meaning under all chapters of the Code.

C. The Use of §506 Does Not Enable Chapter 7 Debtors to Receive More Than They Would Receive in a Bankruptcy Reorganization

The court of appeals also found that if chapter 7 debtors are permitted to use §506 to void liens on real property, they will file chapter 7 petitions instead of chapter 11 and 13 petitions, since they supposedly will be gaining more than they could in those chapters. This practice, the court concluded, would eviscerate Congress' preference for

reorganization rather than liquidation. Dewsnup, 908 F.2d at 592.

The lower court is simply wrong that chapter 7 debtors in fact fare better in a chapter 7 as to the application of §506(d) and further, that §506 lien avoidance is the sole reason a debtor would choose, even if qualified for other chapters, to file a chapter 7 petition.

To be sure, the Bankruptcy Code contains inducements for a debtor to choose a reorganization over a liquidation which demonstrates a Congressional preference for debtors to chose the former. However, chapter 7 remains in the Bankruptcy Code as well and retains important purposes such as providing the debtor with a fresh start. Obviously not all debtors qualify for chapter 13 and many are not eligible for chapter 11. Chapter 7 therefore is the only place for these debtors

if they are to obtain a bankruptcy fresh start.

More importantly, the voidability of liens is only one of many factors a debtor considers when choosing between bankruptcy chapters. "Each chapter contains its own special inducements and restrictions and must be evaluated as a whole." Gaglia, 889 F.2d at 1311, (quoting In re O'Leary, 75 B.R. 881, 884 (Bankr. D.Or. 1987)). It is the experience of counsel, who have been utilizing §506 in both chapter 7 and chapter 13 in our representation of debtors, that only rarely do debtors file a chapter 7 bankruptcy primarily to take advantage of 11 U.S.C. §506. To the contrary, most of the cases we file on behalf of debtors who wish to save their homes from foreclosure are chapter 13 cases. We do so to enable debtors to effectively cure or pay off delinquent mortgages through their chapter 13

plans in ways which are unavailable under chapter 7 of the Code.

Every court of appeals, including the 10th Circuit, which has addressed the interplay of §506 and Chapter 13 has held that debtors pursuant to §506 may void all undersecured liens on real property in chapter 13 and that debtors may even modify the contract terms of the remaining secured claims on their homes if the claim is secured by more than the realty itself. Hart 923 F.2d at 1411; Wilson, 895 F.2d at 127-8; Hougland, 886 F.2d at 1183; see generally Collier at ¶1300.73 and ¶1322.06 (claims on debtors' home may be bifurcated and unsecured portions modified in a chapter 13).

In a chapter 7 case, debtors may void the unsecured part of a real property lien but may not modify the remaining secured claim, except as may be provided by applicable state law.

Chapter 7 debtors cannot cure a delinquency on the lien nor may they force the lienholder to accept payment of the allowed secured claim over time, as is permitted in chapter 13. 11 U.S.C. §§1322(b)(3), (5), and (6). As Judge Posner pointed out:

> [O]nce the strip downs were complete and the secured claims allowed in their stripped down amount, . . . the only thing that remained to do in the bankruptcy proceeding was to discharge the debtors and let the creditor, foreclose their stripped-down liens, subject to whatever rights of redemption the debtors may have, under state law, in the foreclosure proceedings . . . The [debtors] forget that they chose to proceed under Chapter 7 of the Bankruptcy Code . . . If the [debtors] wanted to hold on to their property they should have sought reorganization under Chapter 13. In reorganization secured creditors may be prevented from foreclosing; may be forced to substitute a new security interest for their original interest. . .

Lindsey, 823 F.2d at 191; see also, Gaglia, 889 F.2d at 1310.

Likewise in a chapter 11 case, there is nothing, for the most part, which enables

creditors to escape a §506 determination. Creditors' claims are determined for secured status and liens are voided to the extent undersecured. 11 U.S.C. §§ 103(a), 506(a) and (d). See Tarnow, 749 F.2d at 465. As stated in Part I. B. supra, the one exception exists for nonrecourse creditors under certain circumstances. 11 U.S.C. §1111(b)(2).[18]

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[18] It should be noted that respondents are recourse creditors.

IV. CONCLUSION

Since the plain meaning of 11 U.S.C. §506 mandates that chapter 7 debtors may void liens to the extent undersecured, regardless of whether the property has been abandoned, and since such a reading furthers the purposes and policies of the Bankruptcy Code, amicus curiae requests this Court to reverse the judgment of the court of appeals.

Respectfully submitted,

MICHAL FOX MIVASAIR
IRWIN TRAUSS
HENRY J. SOMMER
COMMUNITY LEGAL SERVICES, INC.
1315 Walnut Street, Suite 400
Philadelphia, PA 19107
(215) 427-4850

ROBERT SABLE
NATIONAL CONSUMER LAW CENTER
11 Beacon Street
Boston, MA 02108